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EXAMINATION OF THE FINANCIAL CONDITION OF THE FARM CREDIT SYSTEM

HEARINGS

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

OCTOBER 31 AND NOVEMBER 1, 1985

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EXAMINATION OF THE FINANCIAL CONDITION OF THE FARM CREDIT SYSTEM

THURSDAY, OCTOBER 31, 1985

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 9:35 a.m, in room SR-328A, Russell Senate Office Building, Hon. Jesse Helms (chairman of the committee) presiding.

Present: Senators Helms, Dole, Cochran, Boschwitz, Hawkins, Andrews, McConnell, Zorinsky, Leahy, Melcher, Pryor, Boren, Dixon, Heflin, and Harkin.

STATEMENT OF HON. JESSE HELMS, A U.S. SENATOR FROM NORTH CAROLINA

Senator HELMS. The committee will come to order.

Good morning, Senator Boschwitz, Senator Hawkins, and Senator Zorinsky.

This morning, we begin our review of the difficulties—and they are substantial—confronting the Farm Credit System. We will hear testimony on the current financial situation of the System, projections of its future viability, and proposals to ensure the integrity of this vital source of credit to our Nation's farmers.

I do not think there is anyone who is not aware of the importance of the Farm Credit System to our agricultural economy.

The 37 banks of the System, with their almost 800 local associations, hold about one-third, or just over $70 billion, of the $212 billion farm debt. The System currently has almost 1 million borrowers.

Now, this lender is unique in two important ways. The first is that credit can be extended only to agriculture. Therefore, without a diversified loan portfolio, stresses in this single segment of our economy quickly result in financial difficulties for the System.

We are acutely aware of the problems many farmers are facing. There is a great deal of rhetoric—reasonable, substantial, political—flying through the air all across the country. But the fact remains, significant numbers of loans in nonaccrual status cannot be carried indefinitely without severe disruption in the ability of the System to operate efficiently.

The second unique aspect of the System is that the only way it has to raise funds is to sell bonds to private investors. Deterioration in confidence by bond investors and the viability of these securities will cause difficulty in raising necessary loan funds and will certainly increase the cost of credit to farm borrowers.

Now, everybody has a solution to every problem around this place, but I would say to my colleagues on this committee and to others that solutions are far from simple. However, I am confident that we will be able to craft expeditious legislation that will shore up confidence in the System, institute necessary regulatory modifications, and above all, provide assistance to the farmers who depend on this source of credit

Let me emphasize that point. There is no practical sense in our enacting legislation that will serve only to keep these lending institutions in business unless substantial assistance will accrue to their borrowers. Fiscally responsible measures to ensure adequate credit at affordable interest rates must be our goal.

Now, obviously, I have kept my remarks brief in order that we can have ample time to review the testimony of our witnesses, and recognizing time constraints this morning, I know that other members of the committee will want to do likewise.

Senator Zorinsky.

STATEMENT OF HON. EDWARD ZORINSKY, A U.S. SENATOR FROM NEBRASKA

Senator ZORINSKY. Thank you, Mr. Chairman.

I commend you for convening today's hearing. However, I am afraid that what we are about to hear regarding the depth of the farm credit problem is only going to complicate our task as floor managers of the 1985 farm bill.

The fact that we find it necessary to take testimony on the present problems in agriculture, and specifically, to review the financial condition of the largest lender to agriculture—which is the Farm Credit System—highlights the importance of the farm bill debate on the floor of the Senate.

Surely, except for the almost total disaster of farm income, we would not have to concern ourselves with the debt-servicing problems of farmers or the effect of those problems on their lenders. No matter what we do to address the credit problems, we must keep in mind that those problems are only symptomatic of the large underlying problem of the farm economy, which is the lack of profitability.

Put simply, the real problem here is that there is just too much debt in the hands of farmers who have too little repayment capability. The Farm Credit System is an important part of the U.S. agricultural machinery. It holds about one-third of all the farm debt and about half of all the mortgage debt in agriculture.

The System's sheer size and importance of agriculture make its problems impossible for us to ignore. The Farm Credit System's third quarter numbers highlighted the severe depth of its problems. Operating losses exceeded $500 million for a 3-month period. Nonaccrual loans increased by more than 100 percent in the last 6 months, and there was an increased cost extracted by Wall Street from the System and its borrowers for the use of money. All of these factors underscore the need for Congress to act on the System's problems and to act on them soon.

Mr. Chairman, in my judgment, we should concentrate on four areas First, we must address the need to stabilize real estate values. For example, in my home State of Nebraska, real estate values have declined 53 percent since 1980 and almost 30 percent during the last year. Farmers in Nebraska and other States cannot afford to lose any more of their equity.

Second, we need to find a way to reduce the financial pressures on lenders to collect loans through foreclosures, and we must provide lenders an incentive to restructure loans.

There is no doubt that bank officers have fiduciary responsibilities that are influencing their loan servicing actions. We must recognize this fact and consider providing banks assistance in dealing with borrowers in a more compassionate way.

Third, we need to make it clear to the financial markets and investors in the Farm Credit System that the Federal Government stands ready to assist efforts by the System in maintaining the System's vital role in financing U.S. agriculture. If the System cannot provide sufficient capital to agriculture because of a limited ability to market its securities, the cost of credit for all farmers will increase.

Finally, whatever action we take must be sufficient to assure farmers that they will be able to obtain credit at reasonable rates of interest in 1986 and future years. A solution that assures credit availability but assures it at only a higher cost is no real solution to the farmer's problem.

From what I have read so far about the administration's proposal to help the Farm Credit System, it sounds as if it might guarantee the System access to Wall Street, but do precious little for the farmers of America.

I look forward to hearing the comments of both the administration and the System on this issue.

Earlier this year, I took the lead in proposing a substantial strengthening of the Farm Credit Administration's regulatory powers. I intend to continue to press for reform in this area because I believe it is important for the protection of the System's stockholders, its investors, and the taxpayers. This issue must neither be overlooked nor set aside.

Mr. Chairman, as we receive testimony on the Farm Credit System, I believe it is important that we keep a few things in mind. The Farm Credit System remains a locally owned and locally controlled cooperative lending institution. The System's actions are directed by over 5,000 farmers who sit on the boards of the System's individual banks and associations. As a cooperative, it is the System's farmer-borrowers who will be the ones who will either benefit or suffer by the actions we eventually take.

We also must keep in mind the fact that credit problems affect not only the Farm Credit System but rural commercial banks as well. The needs of their farmer-borrowers must be considered along with the Farm Credit System's needs.

Mr. Chairman, I look forward to hearing the testimony of the witnesses.

The **Chairman**. Thank you, Senator.

The distinguished majority leader.

STATEMENT OF HON. BOB DOLE, A U.S. SENATOR FROM KANSAS

Senator **Dole**. Mr. Chairman, I have a news release which I would like to have included in the record.[1] I do not disagree with the comments of the distinguished chairman or of the Senator from Nebraska.

I do commend the chairman, Senator Hawkins, Senator Boren and others, for pressing for these hearings; I think they have been needed. But I would hope that before we adopt a solution, we will find out what the problem is.

We are not here to rubberstamp what the Farm Credit System tells us they need, nor what the administration recommends. It seems to me we have a little different responsibility, and the bottom line is what are we going to do to protect the farmers. That is pretty much the thrust of the statement of the Senator from Nebraska.

We need to find out how we got into this mess and how the Farm Credit System got into this mess and what they plan to do in addition to asking for Federal funds to restore some stability to the System.

There have been a lot of statements made by officials of the Farm Credit System that I think have had an adverse impact on the American farmer. It seems to me that this is the only way to settle it, to have the hearings, ask the hard questions of both the System and the administration, and we in Congress have to be sort of a jury.

I would also say we should not rush into something and try to drop an amendment onto the farm bill. We have got all we can say grace over now in the farm bill, and it may take a little more thought to come up with a real solution, or an amendment that might solve the problems of the Farm Credit System and yet more seriously, the American farmer.

We also have to keep in mind that in addition to the Farm Credit System, we have a number of small commercial banks in our States—every one of our States have heavy agriculture loans—that we cannot just pass over, either. We may want to address those in the concerns of the Farm Credit System, and we may also need to take a look at what may be happening in that area, if we have that jurisdiction—that may be involved in the Banking Committee.

So I would ask that my statement be made a part of the record, and I thank the chairman for having these hearings.

I have just said on the floor that it will probably be about 1 or 2 o'clock before we get back to the farm bill. These hearings may run well beyond noon.

The **Chairman**. Thank you, Senator Dole.

Senator Dixon.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM ILLINOIS

Senator **Dixon**. Mr Chairman, I have a statement which I ask be placed in the record.[2]

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[1] See p. 157 for a news release from Senator Dole.

[2] See p. 158 for the prepared statement of Senator Dixon.

But commenting upon what the distinguished majority leader has said, I want to talk for just a moment about the private sector lending institutions, though I know this is not the nature of this hearing. The Chair knows that previously, during the course of the hearings on the farm bill during the markup in the committee, I mentioned my unique position as a member of the Banking Committee and a member of the Agriculture Committee, and indicated that I have introduced a bill, S. 1151, that is endorsed by both the Independent Bankers' Association of America, which is essentially the smaller agricultural institutions, and the Farm Bureau. It simply provides that agricultural banks are defined as banks under $200 million, which have more than 25 percent of their loans in farm loans. The agricultural banks could write down the loans, in negotiations with the farmers to be valued as collateral, and then amortize the debt over 30 years. That bill also gives these small banks the same bookkeeping authority that the System gave to thrifts a few years ago when they had all of their serious difficulties.

This is a bill that has no budgetary impact. It is a private sector initiative, and it does not solve all our problems, but it certainly is a unique idea—incidentally, not mine, and I do not claim credit for it—but it has a lot of value, and I would like every member of the committee to think about the possibility of that legislation, which helps the banker and the farmer.

Senator BOSCHWITZ. What was the provision, that you could write off part of your debt——

Senator DIXON. If you had a $1 million loan with a farmer, and his land is worth only $600,000, the bank could renegotiate the loan down to $600,000, and amortize $400,000 over 30 years. Also, included is the bookkeeping authority that we gave to the thrifts 3 years ago when they had their problems.

Senator BOSCHWITZ. Like the capital certificates?

Senator DIXON. Yes. I think it is a bill that has a lot of appeal in the farm sector of our country, and I would just like the committee to think about it—S. 1151.

The CHAIRMAN. Thank you, Senator.

Senator Boschwitz.

Senator BOSCHWITZ. Well, Mr. Chairman, I defer, if I may, to Senator Hawkins, who is a member of the subcommittee and I think has a statement, as I do.

The CHAIRMAN. Very well.

STATEMENT OF HON. PAULA HAWKINS, A U.S. SENATOR FROM FLORIDA

Senator HAWKINS. Thank you, Mr. Chairman.

Affordable credit is vital to American farmers. As with any other business venture, the availability of credit provides farmers with a source of cash, to meet their current needs and allow for expansion and growth. But unlike other businesses, a farmer's income flow is sporadic. Annual income can only be determined after the crops are harvested, and sometimes months after the initial outlays required for planting, fertilizing, and conditioning of farm machinery.

A loan up-front is necessary more often than not for farmers working to preserve their way of life.

As chairman of the Subcommittee on Agriculture Credit and Rural Electrification, I would like to review developments in this credit area before the hearings begin.

In recent weeks, the plight of the cooperatively owned and federally chartered Farm Credit System has been splashed across the pages of the Wall Street Journal for all members of this committee and all the world to read.

Why should the Nation's leading financial daily carry the details of a story that focuses on the health of rural financial institutions that predominantly serve the Corn Belt and the agricultural South? The answer to that question lies in the fact that the Federal Farm Credit System has only two means of financing the loans that it makes to its owner-borrowers. Federal land banks and PCA's, or production credit associations, require the purchase of capital stock by those who take out loans. The bulk of the System's capital is raised through the sale of securities in the New York bond market.

The confidence of the New York traders in the health of the Farm Credit System is vital to the availability of affordable credit in rural America.

The news about the System that has been published in the Wall Street Journal has done a great deal to undermine that confidence. The result is costly, because for each increase in the Farm Credit System's cost of funds in the bond market, America's farmers will be left to pick up a multimillion dollar bill. That bill would be paid through higher interest rates on Farm Credit System loans. Higher interest rates are the last thing struggling farmers need today.

The Farm Credit System provides one-third of all U.S. agriculture credit, and it is high time the United States moved to restore confidence in that System. These hearings are the first step.

I refer Senators to the chairman of the Senate Agriculture Committee's statement of October 18, 1985, hearings that were scheduled for October 17 and 18, were delayed at the written request of the credit institutions that are seeking Federal aid in this regard.

As this Senator has prepared for the hearings, one thing has become clear to me. The Farm Credit System needs someone to keep a watchful eye on its lending practices and its methods of operation.

I have a question for the Farm Credit System: How can it be that such a large lending institution does not know its financial condition? Why is it that we have had to delay congressional hearings so the System can take stock of its position?

It is unfathomable to this Senator that the largest single source of agriculture credit cannot provide at any given moment accurate, verifiable financial information.

I ask committee members to consider the following scenario. For over 4 years, the chief regulatory officer of the Farm Credit System testified at Senate hearings that all is well. As recently as the first of August, the Governor of the Farm Credit Administration made public statements—and I would like to enter that in the record—

that the Farm Credit System had all the internal resources necessary to handle any problem that arose within System institutions.[1]

Suddenly, within 1 month of this statement, the "all is well" statement, the same individual announces to the Wall Street Journal that that Farm Credit System will need a massive infusion of capital from the Federal Government. The reason given is the general collapse of the farm economy.

This collapse has undermined the equity underlying the Federal land bank loan portfolio. The Farm Credit System, with total capital of over $8 billion, suddenly claims it will need a multibillion dollar infusion from the taxpayers to survive.

Farmers who own stock in the System become alarmed at the news. The New York bond market, the Farm Credit System's sole source of funds to make new farm loans, is shocked. The Farm Credit System's cost of raising capital soars to new heights. The Wall Street Journal reports that Price-Waterhouse, a name we all know, one of the "Big 8" accounting firms, is conducting the first ever—the first ever—independent audit of the Farm Credit System.

According to news reports, the Price-Waterhouse audit is uncovering exceedingly large loan losses.

At this point, Members of the Senate begin asking to see the Farm Credit System's books, a normal request. Many Senators have the same question for the Farm Credit System. Senators are concerned about the farm owner-borrowers in their States. The farmers' stock appears to be at risk. The interest rates on new farm loans is rising. In the Western farm States, the Federal land banks move forward with large numbers of foreclosures. Again, Senators ask the Farm Credit System to come up with some numbers.

No answer is received from the Farm Credit System. So then Senators ask for assistance in this matter from the regulator. The Farm Credit Administration, charged with the supervision and examination of farm credit institutions, does not know the financial condition of the System banks, either.

Finally, after several weeks, a separate entity—not the System, not the supposed regulators, not an independent auditor, but the System's financial intermediary, publishes something called "The Unaudited Combined Condensed Financial Statements and Financial Commentary," which I have in my hand and will enter in the record.[2]

This document is just 11 pages long. It purports to provide accurate information on an institution that has $74 billion in outstanding loans. This document does not carry the seal of an independent auditor. It is not put out by the Farm Credit System. It is not put out by the System regulator. But it appears that the U.S. Senate is going to be asked to accept these numbers as the basis for a multibillion dollar financial assistance package.

This is not just a scenario. This is really the way that the Nation's largest agricultural lender, holding one-third of all agriculture credit, is approaching its request for financial assistance.

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[1] See pp. 158-162 for the statements of Mr. Wilkinson referred to by Senator Hawkins.

[2] See p. 199 for a reprint of the financial statements referred to by Senator Hawkins.

I hope other Senators agree that this is a ridiculous way to run the railroad. I am determined when all is said and done that the Farm Credit System and its regulatory agency will know the condition of the land banks, the PCA's, and the banks for cooperatives at any given moment of time. There will be reliable information about the Farm Credit System. In the future, a System will be in place that allows for early warning signals of financial distress.

In the future, when a Senator or a farmer-owner asks about the condition of the Farm Credit System, an accurate, verifiable answer can be provided in a timely manner.

If the Senate does nothing else on the issue of farm credit, it must address the regulatory scheme of the Farm Credit System. We owe it to the farmer. Farmers own the System. The farmers are getting the worst of a very bad bargain. Their stock appears to be endangered, and their interest rates are rising.

We owe it, as Senators, to the taxpayers. The taxpayers are plagued with high interest rates. A multibillion dollar bailout of the Farm Credit System will add to the deficit—that is what we have been talking about all year—and push interest rates higher, as well.

When history records this episode, I hope it will say that when the U.S. Senate saw this problem, it acted responsibly and in a forthright manner to solve both the short- and the long-term problems of the Farm Credit System. Clearly, there is a need for reform of the System regulator. There is a need for a strong independent agency to keep an eye on the Farm Credit System. This regulatory agency will be charged with the regulation and examination of farm credit institutions. I am drafting legislation to reform the regulatory scheme of the Farm Credit System.

During and after these hearings, I invite Senators to join me in working out an effective and fair system for regulating this Farm Credit System.

Mr. Chairman, I ask unanimous consent to enter a number of newspaper acticles, published statements, and financial information in the record for the benefit of other Senators. They provide a good chronology of events as they developed in regard to the Farm Credit System over the past several weeks.[1]

I thank the chairman.

The CHAIRMAN. Without objection, so ordered.

Well, Governor Wilkinson, do you want to back out now?

Mr. WILKINSON. I will stay right here, Senator.

The CHAIRMAN. Senator Boschwitz.

STATEMENT OF HON. RUDY BOSCHWITZ, A U.S. SENATOR FROM MINNESOTA

Senator BOSCHWITZ. Mr. Chairman, I have a statement that will take just a few minutes. I have some charts as well.[2]

I must say, I agree with the Senator from Florida when she says the Farm Credit System needs to have more oversight. Maybe we should send around the Comptroller of the Currency or the FDIC, but certainly, something of that nature.

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[1] See pp.158-210 for the material referred to by Senator Hawkins.

[2] See 210 for the prepared statement of Senator Boschwitz.

Mr. Chairman, cash-flow is certainly the root problem of agriculture, and most farmers with cash flow problems also have credit problems. They have too much debt, and their interest rates are too high.

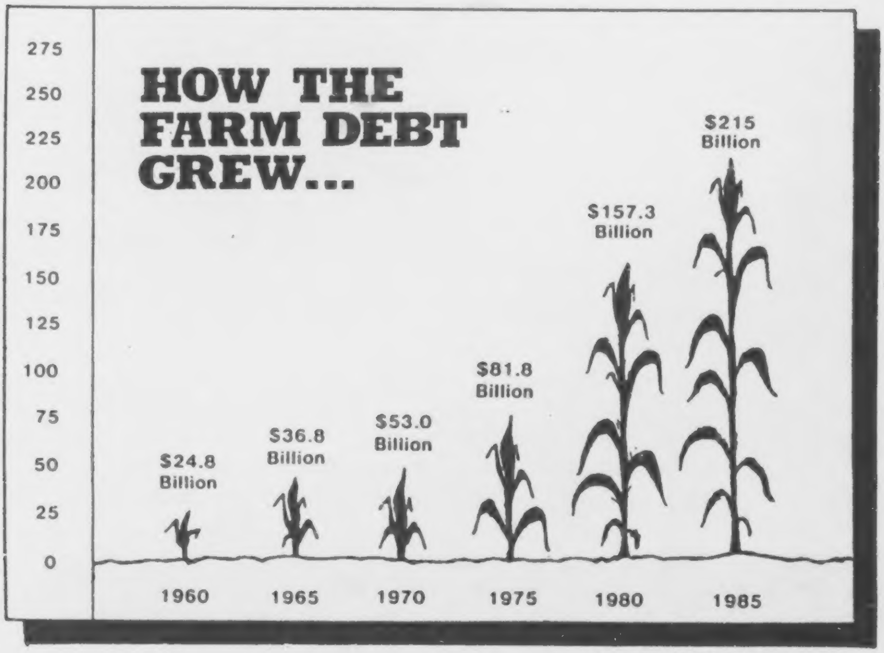
I believe the credit problem of agriculture is far more easily solved, Mr. Chairman, than determining the right course of the 1985 farm bill and all the complications that go along with that.

Also, farm credit, in my judgment, is a far cheaper problem to solve than the farm bill. Weather, world markets, currency values, or general economic conditions among consuming nations, yields, set-asides—all those variables do not exist here. The amount of debt, who holds it, where the trouble is, and the cost of fixing it is far more easily defined.

Admittedly, interest rates are unpredictable, but they seem to be fairly stable at the present time and should be predictable within a reasonable range. Mr. Chairman, if we could ease the farm credit problem, we would go a long way in restoring confidence in rural America.

The amount of farm debt is about $215 billion—I know you said $212 billion, and the figure sometimes varies—I might say that it is stable; it is even going down just a little bit—$112 billion is long-term debt, and $103 billion is short-term debt.

I have this little chart here—I will take advantage of the folks with the TV cameras, if you do not mind, Senator Pryor—it shows that farm debt has grown very rapidly.



Chart/Senate Republican Conference

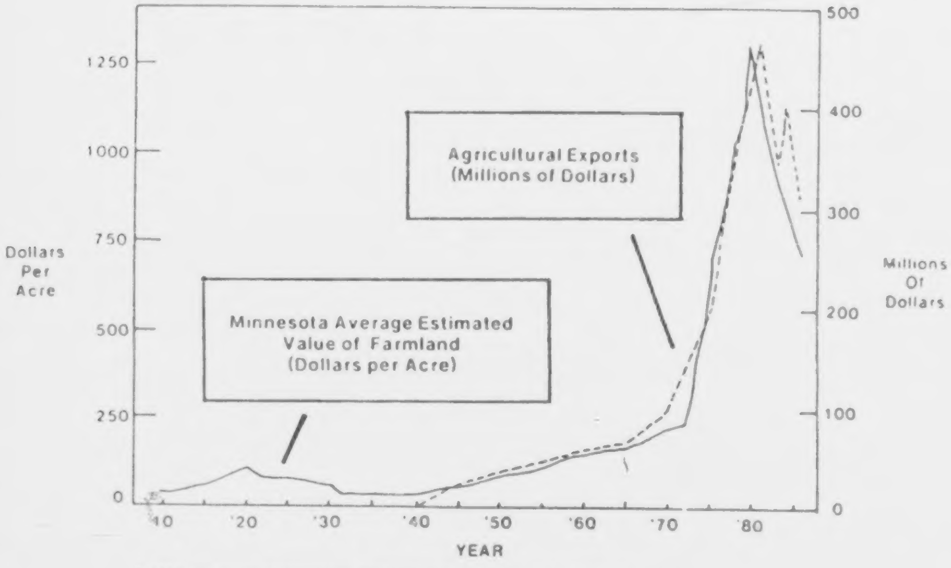
Senator Andrews. I wish my corn grew that fast.

Senator Pryor. I do not even want to say who prepared this chart.

Senator Andrews. Who did?

Senator Boschwitz. How did that farm debt rise so rapidly? It is really not much different, Mr. Chairman, than the consumer debt or loans to foreign countries. Inflation rates exceeded interest rates. Interest payments are tax deductible. There was a pervasive psychology that inflation was with us to stay. All of that led to a lot of bad advice that many people took.

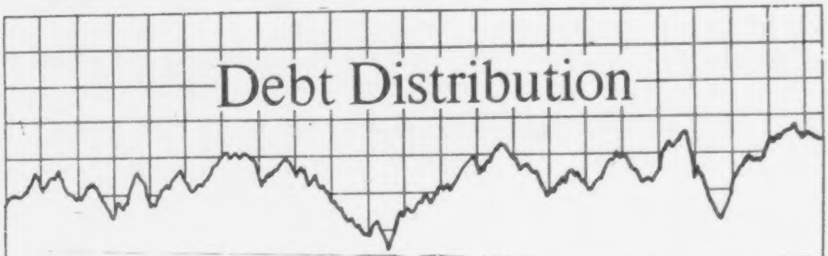
Amazingly, however, many farmers did not. You know, they would go down and drink coffee in the morning, and they would be told they were millionaires, and that they should really borrow against their rising farm values, and most of them did not. It is just amazing. Most farmers are still debt-free. In fact, the largest group of farmers is still debt-free.



Source: University of Minnesota, Department of Agricultural and Applied Economics

The 1970's sure represent a convincing argument, Mr. Chairman, for stable and fairly conservative and most of all, consistent economic policies.

Who holds the farm debt? I have also given you a chart on that, Mr. Chairman, and it is interesting to note on this "Debt Distribution Chart" who holds the farm debt. I break it down into short term and long term. I do that because the solutions to the debt problems are different if it is an insurance company or a commercial bank or the Farm Credit System, or individuals, for that matter. Individuals are much easier to cope with—so are insurance companies—than the Farm Credit System or the banks. You will see the Farm Credit System is probably the largest single lender, but the other components of it also are quite large.



	Short-term %	Short-term $ (billions)	Long-term %	Long-term $ (billions)
Banks:	37.9	39.0	8.4	9.4
Insurance Co:	--	--	11.4	12.8
Individuals:	18.4	18.9	29.0	32.5
CCC:	10.5	10.8	--	--
FmHA:	14.2	14.6	8.3	9.3
Farm Credit System PCA's:	19.0	19.6	--	--
Land Bank:	--	--	43.0	48.1
Total:	100	103	100	112

Chart /Senate Republican Conference

Senator DIXON. The banks are the largest lender, aren't they?

Senator BOSCHWITZ. No, the banks are not the largest lender—in short-term debt, they are.

Senator DIXON. Short term, yes.

Senator BOSCHWITZ. But not for long term.

OK, short-term debt, the banks are the largest holders; long-term debt, the rather small holders. The Farm Credit System is down here. The Federal land bank is the largest long-term holder. Individuals are the second largest long-term holders, and insurance companies are quite large, as well. The FmHA, as you see, is also listed there.

Senator DIXON. Nice graph.

Senator BOSCHWITZ. Thank you very much.

Senator ANDREWS. But why all in reds and yellows, and no greens?

Senator DIXON. There is a little green in the other one.

Senator BOSCHWITZ. Well, I see the Republican conference made this up, and apparently, the person who did this liked yellow. [Laughter.]

Now, who holds the farm debt in the Farm Credit System? If you look at this one, Senator, you will see that there are two pages, and on top of one page it says, "Nonreal Estate Debt," which would be the short-term debt, and then the long-term debt. The districts of the Farm Credit System are broken down there, and you will see who holds the debt in the various Farm Credit Systems.

Who Holds the Farm Real Estate Debt—By FCS Districts

	Percent
Springfield (ME, NH, NY, MA, CT, RI, DE, NJ, VT):	
FLB	39.0
Insurance company	1.7
Commercial banks	7.4
FmHA	18.8
Individual/Other (2.8 percent of total debt)	33.0
Baltimore (MD, PA, WV, VA):	
FLB	44.3
Insurance company	2.7
Commercial banks	15.9
FmHA	10.5
Individuals/Other (2.4 percent of total debt)	26.6
Columbia (NC, SC, GA, FL):	
FLB	56.8
Insurance company	10.3
Commercial banks	7.6
FmHA	8.8
Individual/Other (5.7 percent of total debt)	16.5
Louisville (KY, TN, OH, IN):	
FLB	39.7
Insurance company	8.8
Commercial banks	7.6
FmHA	9.2
Individual/Other (7.6 percent of total debt)	27.2
Jackson (MS, AL, LA):	
FLB	51.7
Insurance company	12.5
Commercial banks	12.2
FmHA	10.1
Individual/Other (4.5 percent of total debt)	13.5
St. Louis (MO, AR, IL):	
FLB	40.7
Insurance company	13.1
Commercial banks	11.7
FmHA	8.5
Individual/Other (9.8 percent of total debt)	26.1
St. Paul (MN, WI, MI, ND):	
FLB	46.4
Life insurance	5.0
Commercial banks	7.8
FmHA	8.6
Individual/Other (15.0 percent of total debt)	32.1
Omaha (NE, IA, SD, WY):	
FLB	37.8
Life insurance	12.2
Commercial banks	4.1
FmHA	8.4
Individual/Other (18.4 percent of total debt)	37.4
Wichita (KS, OK, CO, NM):	
FLB	49.2
Life insurance	10.8
Commercial banks	6.2
FmHA	8.9
Individual/Other (10.7 percent of total debt)	25.0
Texas (TX):	
FLB	36.6
Life insurance	14.9
Commercial banks	11.2
FmHA	5.8
Individual/Other (6.9 percent of total debt)	31.5

	Percent
Sacramento (CA, UT, AZ, NV, HI):	
FLB	40.1
Life insurance	21.3
Commercial banks	6.2
FmHA	3.3
Individual/Other (9.8 percent of total debt)	29.0
Spokane (WA, OR, ID, MT, AL):	
FLB	37.1
Life insurance	14.3
Commercial banks	1.7
FmHA	8.7
Individual/Other (6.3 percent of total debt)	38.2

Who holds farm non-real estate debt—by FCS districts

	Percent
Springfield (ME, NH, NY, MA, CT, RI, DE, NJ, VT):	
PCA	27.7
Commercial banks	47.1
FmHA	23.0
CCC (2.1 percent of total debt)	2.7
Baltimore (MD, PA, WV, VA):	
PCA	35.5
Commercial banks	36.1
FmHA	24.0
Individuals/Other (3.7 percent of total debt)	2.4
Columbia (NC, SC, GA, FL):	
PCA	37.7
Commercial banks	19.1
FmHA	41.3
CCC (7.6 percent of total debt)	1.8
Louisville (KY, TN, OH, IN):	
PCA	30.8
Commercial banks	41.6
FmHA	20.1
Individual/Other (10.6 percent of total debt)	7.2
Jackson (MS, AL, LA):	
PCA	18.4
Commercial banks	24.5
FmHA	51.1
CCC (4.8 percent of total debt)	4.5
St. Louis (MO, AR, IL):	
PCA	16.1
Commercial banks	55.2
FmHA	17.4
CCC (11.1 percent of total debt)	11.0
St. Paul (MN, WI, MI, ND):	
PCA	26.3
Commercial banks	39.5
FmHA	13.2
CCC (13.1 percent of total debt)	19.6
Omaha (NE, IA, SD, WY):	
PCA	14.1
Commercial banks	55.2
FmHA	10.5
CCC (14.3 percent of total tax)	19.5
Wichita (KS, OK, CO, NM):	
PCA	14.0
Commercial banks	54.1
FmHA	10.9
CCC (8.9 percent of total debt)	19.2
Texas (TX):	
PCA	16.7
Commercial banks	48.3
FmHA	18.2
CCC (5.7 percent of total debt)	13.8
Sacramento (CA, UT, AZ, NV, HI):	
PCA	30.0
Commercial banks	57.2

	Percent
FmHA	10.6
CCC (9.9 percent of total debt)	1.4
Spokane (WA, OR, ID, MT, AL):	
PCA	25.6
Commercial banks	42.4
FmHA	14.2
CCC (8.3 percent of total debt)	17.4

Senator Boschwitz. If you are in the St. Louis district, Senator Dixon, you will see that the Federal land bank holds 41 percent of your long-term debt; insurance companies, 13 percent—so you can follow.

Also shown here is what the total debt is as a percentage of the whole. That is, in the nonreal estate debt, St. Paul district, which is the largest district, has 13 percent of the total debt. In real estate, they have 15 percent. The key to the districts is noted.

Senator Pryor. Excuse me, Senator. What is the "Individual/Other"?

Senator Boschwitz. You know, you sold your farm to your son, or a contract fee type of situation. There is a lot of that, and I will address that very specifically, if I may. May I?

The Chairman. Well, let me just say, Senator, that I was looking through the parliamentary procedures book for the House of Lords 2 or 3 days ago, and I saw a motion available to members of that body that is not available to us, and that is, you can move that "The noble Lord may be heard no further." [Laughter.]

Senator Boschwitz. Mr. Chairman, these hearings have been delayed for months, and I mentioned to your staff yesterday that I would appear here and speak this morning. I would like to make this opening statement.

The Chairman. The floor is yours, Senator. I am just saying we have got witnesses scheduled, too.

Senator Boschwitz. Well, the witnesses, Mr. Chairman, represent the Farm Credit System, and they can wait.

The Chairman. Well, certainly, they can, but I thought you wanted to put the "bee" on them a little bit, too.

Senator Boschwitz. I will, in a minute.

The Chairman. Proceed as you wish.

Senator Boschwitz. Thank you, Mr. Chairman.

Mr. Chairman, I described the Farm Credit System, which is the Federal land bank, the production credit associations, and the banks of the cooperatives. They have a total of approximately 74 billion dollars' worth of loans, though interestingly, their loan volume declined by $4 billion in the past 3 months. Most of the loan volume is in the Federal land bank; it is $51 billion. They have 650,000 loans, and the production credit associations have 312,000 loans of $18 billion; the banks for cooperatives is the smallest.

Interestingly, Mr. Chairman, I am told that the capital structure of the Farm Credit System still, today, remains stronger as a percentage of assets than the banking system. The capital of the Farm Credit System has developed through profits, and farmer-borrowers have to purchase stock equal to 5 percent of their loans. So the Farm Credit System's problems are not as much capital-related; they are really problems of liquidity.

The Farm Credit Administration—I agree with the Senator from Texas—has to be strengthened so it has more oversight capabilities.

What should be done on farm credit? I break it down, Mr. Chairman, on the basis of who holds the farm credit: one, credit held by other individuals. Individuals holding the debt are quite large, and they now, of course, have a great deal of flexibility. They are dealing one person to the other, and they can forgo principal payments; they can reduce interest as well, but they are precluded from reducing interest by the imputed interest rule.

An individual, if he is dealing with a family member, his son, can reduce the interest to 6 percent. If he is dealing with a third party, it is 9 percent. So, to increase the flexibility to nonfamily transactions, I would favor lowering the imputed rate to 6 percent for a 5-year period on the very large portion of the farm debt that is held by individuals.

Senator DIXON. We did not take that up on the imputed interest legislation, did we?

Senator BOSCHWITZ. No, we did not. We tried, and we made an exclusion for farmers up to $500,000.

Senator DIXON. I know we did that.

Senator BOSCHWITZ. Right. But we should do so also for nonrelated parties.

Credit extended by banks to the Farm Credit System. I go along with S. 1151 here, Senator Dixon. I believe we need a program that targets assistance to the family-size commercial farmer. They make up about a third of all the farmers, with nearly 65 percent of the total farm debt. According to the Federal Reserve, that is where most of the debt problems lie.

So, in order to be eligible for the program that I would suggest, farmers would have to have gross annual sales of $30,000, and a debt-to-asset ratio exceeding 40 percent. So the small hobby farmer would be excluded, and people whose debt situations are not extreme would also be excluded, and we would target the family-size commercial farmer.

Banks and insurance companies in the Farm Credit System would be eligible, and farmers who have gross sales, as I say, in excess of $30,000 and a debt-to-asset ratio exceeding 40 percent.

It would be a 3-year program, and there would be an interest buydown, where the Federal Government would buy down 2 percent of the interest, the State would buy down 2 percent, and the bank would have to give 1 percent. So that 5 percent of the interest rate would be bought down, and the interest rate would be attached to the Treasury rate, so that the interest rate would be a controllable item and not anything the lender would want to establish.

In the event the State did not want to participate, we would nevertheless go forward, and it is our estimation that the Federal Government's cost for the 2 percent would be $1.3 billion.

There would also be a principal forgiveness—and Senator Dixon, this is very much along the lines that you suggested—principal forgiveness up to 30 percent, and the 30 percent could be written off over a 10-year period. We would grant these banks a certificate, a capital certificate. But we would have to be careful that they are not abused, because they were abused in some of the savings and loan instances. But therefore, the banks would not have to take the capital entirely in 1 year, and they like that 10-year write-off, and in the event they write off more than 15 percent of the debt, they would not have to give the 1-percent write down.

So basically, what we are looking at is a 4- to- 5-percent interest write down, a 30-percent write down of the debt. That would apply in the case of the bank, and that would apply in the case of the Farm Credit System. In the case of the insurance company, there would not be any Federal incentive for a write down. They do not have bank examiners looking over their shoulders, and neither do individuals. But they would, however, be eligible to the interest buy-down provision.

We then also have a rather long provision about warehousing the loans of the Farm Credit System in their new capital bank in Denver, and transferring to that capital bank some of the surplus capital that exists in some of the districts. The Farm Credit Systems in the districts have always been thought to be liable for the entirety of the debt, but that is a very ill-defined liability, I might say, and some of the districts are dissipating some of their capital, so they will not have to put some of their capital into a failing bank somewhere else. These banks are in Illinois or more likely in the Omaha district, or the St. Paul or the Spokane district. These latter two, Spokane and Omaha, are having the most trouble at the present time.

But we would take those nonperforming loans, after writing down the loan 30 percent, giving a 5-percent interest buy down, and if they still are nonperforming, we would put it into the capital corporation that has already been established in Denver, and then we would allow the Denver bank to lease the land. The lease on that farm would be back to the farmer for a 5- or 10-year period, and the farmer would be entitled to buy the farm back at the end of that period at the then market price, although the title during that period goes to the Farm Credit System. Now in the event the Farm Credit System needed more capital at that central bank, we would be in favor of allowing the central bank to issue a Government-guaranteed loan—it would not be a direct loan, so it would be off budget, and the result would not impact the budget so much.

Banks and other lenders do much to lighten the debt burdens of their customers, and they have already been doing it in many creative ways, particularly rescheduling or laying aside principal payments. But if the Government can add to their "bag of tricks" by one, improving the imputed interest rules of nonfamily transactions; two, by buying down interest up to 5 percent; three, by providing a means to adjust principal up to 30 percent; and four, also clearing an avenue to collect and strengthen the capital of the Farm Credit System, I think we would do much to improve the Nation's agricultural debt situation.

Mr. Chairman, I say, as I said at the beginning, I think we could do much to restore the confidence on the main streets and among farmers of rural America by moving on the credit issue, which in my judgment is easier to do than the farm bill, and much cheaper to do than the farm bill, and therefore I think we should do so with considerable speed.

I apologize for the long statement, but it was my understanding that I was going to make that statement.

Senator **Zorinsky** [presiding]. It was very informative, and we appreciate it.

Senator **Boschwitz**. Thank you.

Senator **Zorinsky**. Next, Senator Pryor.

Senator **Pryor**. Senator Zorinsky, I have no statement at this point. I just look forward to the witnesses' testimony.

Senator **Zorinsky**. Senator Andrews..

STATEMENT OF HON. MARK ANDREWS, A U.S. SENATOR FROM NORTH DAKOTA

Senator **Andrews**. Thank you, Senator.

I do not have a statement, but what I would like to do is lay some ground rules here for, hopefully, what the Governor is going to testify to.

I read through the story of his testimony on the other side earlier today, and all I can see is that he wants $6 billion.

Let me also point out, Mr. Chairman, that things are repeated in this business. I look back, and on February 26, 1974, 11 years ago, the then Governor of the Farm Credit Administration appeared before a committee I happened to be a member of, and I pointed out to him then that, "In your outlook on the agricultural economy you point out the fact that the price of land has gone up 20 percent in the last year."

As my colleague and friend from Minnesota knows, those were the rosy years.

I said, "Our chairman last year made the statement about this whole Russian wheat sale, expressing his concern that this might be a Johnny-one-shot operation."

It sure turned out to be that.

I went on to say, "I think our committee should be concerned with the possibility of what might happen a year or two hence, when wheat is not selling for $5, and when this 20- or 25- or 30-percent hike in land values turns the other way, and we go down."

I asked the then Governor, "Governor, have you checked your loans to such an extent that you are willing to stay with these people even if the bottom falls out of the real estate market?"

I went on to say, "Can you scale down your payments so you do not have to unload these farmers? Have you taken that into consideration?"

The Governor at that time said, "Yes; we are very much concerned. The question is what happens when the high price levels we have had in the last year or two in agriculture come back to previous levels, when we are going to get into a serious cost-price situation."

He went on to say that, "The loan is going to be continued for the 35 years, if that is the maturity, until the maturity date, or until he pays it off. If the management quality is not there, and he has no repayment capability, foreclosure procedures are available."

But then he went on to say, "Carry that loan payment over for an extra year or two? By all means."

Now, here is the Governor of the Farm Credit System back then, when I asked the specific question, "You are not going to keep them to the original terms of the loan; you will give them some forgiveness along the line?" and he said, "You bet."

Now suddenly, we have the current Governor come in and say, well, we do not know if we can give forgiveness. We do not know how we are going to work this out. And suddenly, we are surprised by what we have.

I would like to find out from the present Governor—maybe he could have some people looking for it before his questioning begins—what happened to the program and the plans you obviously had 11 years ago, when some of us were asking you what you were going to do when these events which we could see down the line happened. At that point in time, the Governor pointed out proudly, "We have never had a default on a bond issue. Why? Because these loans are backed up with good farm real estate."

That is the answer we got from the Governor 11 years ago.

These loans are still backed up, Mr. Chairman, with good farm real estate. The value of that real estate has not changed as far as its productivity. The equity is still there. Some arbitrary dollar values have changed.

I would like to find out also from the Governor when he testifies, Mr. Chairman, what his plans are for the use of this $6 billion. I have heard a lot about forgiveness, and that bothers me. How do you tell farmer Anderson that you are going to forgive one-third of his loan and then tell farmer Smith, who lives in the same township, and has the same size loan, because he did not buy a new pickup and a new combine or whatever else, that his loan is not in such bad shape, so you are not going to forgive one-third of his?

These are the specifics, Mr. Chairman, that we ought to be talking about. We know we are in trouble. Some of us have seen it coming for a long time. We would think there would be some better plans down at the Farm Credit Administration.

One of the things that was brought up in the colloquy I had 11 years ago with the Governor was the fact that if you cannot service these loans, are you going to have to push them over into Farmers Home. Today, Mr. Chairman, we have Farmers Home saying, "We are not going to take any new loans."

How does that factor in? How many of the loans does the Governor think are going to have to fall down or fall over or move to Farmers Home? And if Farmers Home is not there, able to take new borrowers, what happens then?

Mr. Chairman, these hearings are extremely important, but I hope, rather than telling us what we already know and dealing in vague generalities that we need $6 billion, I would like to find out where we are going to put it, how we are going to do it in an equitable way, and how we team up with the other factors of Government, Farmers Home, private investors, and the rest.

I would also, Mr. Chairman, finally, like to have the Governor do some thinking, and maybe he can say it in his initial statement or answer it in questions posed by some of us members, regarding what is the impact on his loan quality if we have a price support system voted out in this 4-year farm bill we are now debating that has decreasing values in those out-years? If we have decreasing values of price support in those out-years, does that make a shaky farm long-term loan situation even shakier; does it make no difference at all? If we are going to have to apply $6 billion, would we be better off applying it on the loan side of payments to farmers, or on the bailout side of the Farm Credit Administration?

In other words, do we have a patient who is hemorrhaging, and are we attempting a transfusion before we stop the bleeding? These are questions we ought to get some accurate answers on.

It might be wiser—we might have some facts brought out today and tomorrow wherein it is wiser to shore up prices than to shore up the Farm Credit System.

Maybe I am old fashioned, but I think the Farm Credit System will do all right if farmers have a little bit better income assurance. But then, if that is not the case, this is the place we ought to learn that.

Mr. Chairman, I appreciate your taking the time to hold these hearings. I think they are extremely important. But I would hope we can get some basic facts instead of talking vague generalities.

The CHAIRMAN. I thank the Senator.

Senator Boren.

STATEMENT OF HON. DAVID L. BOREN, A U.S. SENATOR FROM OKLAHOMA

Senator BOREN. Mr. Chairman, I will just take a minute because I do want to get to the witnesses. I appreciate the opportunity that we are having in these hearings. I have felt all along that it was extremely important to have all the information before us about the situation in the Farm Credit System before we proceeded to vote on the farm bill that is now on the floor.

As Senator Andrews has just said, the decisions that we make on the farm bill will have a great impact on what needs to be done in farm credit. If we adopt a bill with declining incomes over the next 4 years, that will put additional pressure on the Farm Credit System, on the private banking system, and other elements that are providing the necessary credit to agriculture. In many ways, if we skimp on the farm bill now, we are going to end up costing the taxpayers a lot more, because we are going to have to expand the size of credit bailout later on as we put the System under additional pressure.

The choices before us in many ways are: Are we going to work on a farm bill that gives the farmers a chance to earn a fair income? Or are we going to wait and be penny wise and pound foolish and come in with a multibillion dollar credit bailout later on that is going to be even larger than the one that is initially being asked for in these hearings today.

So I think it is important that the Members of the Senate have the full information before them about the crisis in the Farm Credit System before we proceed to any kind of final action on the farm bill.

I do think it is important that, as the System testifies today and as we hear from the Farm Credit Administration, we consider the special nature of the System in terms of its own history. I am concerned when I hear, for example, that we are confronting the problems in the current system by doing away with some of the basic elements that have made the System justify its existence from the beginning

I am talking, for example, about the massive consolidation of locally elected boards and the more and more concentrated control in a few hands. It is hard for some of us to understand why the Farm Credit System would deserve special consideration over and above any consideration given to commercial banks and others, if it intends just to be another commercial bank, if it is going to do away with the concept of control by locally elected boards selected by the farmer-owners of the System themselves. So we are concerned by the growing trend toward concentration and centralization in the System, and I expect to ask a number of questions along those lines.

The System, in terms of its own history, going back to the time of the Depression, was also set up primarily to help the family-size farmer and to keep that farmer in existence. Some of us are extremely concerned by the adoption of dual interest rate policies which seem to provide the highest interest rates for those family farmers who are under most stress. So in other words, instead of helping the family farmer, we see preferential treatment in the System now being given to those who are in the best shape, the larger farmer or the hobby farmer who does not depend upon the family farm as the source of his income.

If the Farm Credit System deserves any special consideration from this committee, from those of us in policymaking roles, then I think we need to be assured—we need to be assured that the special nature of that system, local control by the farmer-owners themselves and special consideration of the needs of family farmers, which is really the whole reason why this organization was chartered in the first place and is being continued as a policy.

I think we also have to seriously consider that approximately only one-third of the farm debt is being held by the Farm Credit System itself. The rest of that debt is in the hands of commercial banks, insurance companies, and individuals, as the Senator from Minnesota has indicated in the statistics which he has given to us. And I think that whatever solution we try to devise in this committee, we must be careful that we are not picking and choosing among farmer-borrowers. We should not be giving preference to a farmer, additional help to a farmer, just because he decided to borrow at the land bank or the PCA instead of borrowing from the insurance company or the local commercial bank or from some individual in his community. They are all in trouble, and they deserve equal consideration. I think whatever we fashion has to be fair in terms of how it cuts across the board among lenders, and also how it cuts across the board among borrowers in the farm sector who are in trouble.

So I thank the Chair for giving us this opportunity, and I look forward to hearing the testimony of the witnesses.

The CHAIRMAN. Thank you, Senator.

Senator McConnell.

STATEMENT OF HON. MITCH McCONNELL, A U.S. SENATOR FROM KENTUCKY

Senator McConnell. Thank you, Mr. Chairman. To your relief, I will simply insert my statement in the record, with one observation about Kentucky.[1]

The fourth credit district of the Farm Credit System covers four States including mine. The fourth credit district is not broke yet, but it is fast heading in that direction, and that is why this hearing is so critical to the farmers of Kentucky.

Kentucky's total loan volume of $5.1 billion in the Farm Credit System is such an important part of my State's agriculture that the impact of the collapse of the System would be a virtual depression in rural Kentucky. As bad as things are, Mr. Chairman, we simply cannot let them get any worse.

With that brief observation, I look forward to hearing from the witnesses.

Thank you.

The Chairman. Senator Heflin.

STATEMENT OF HON. HOWELL HEFLIN, A U.S. SENATOR FROM ALABAMA

Senator Heflin. Mr. Chairman, as we go into this hearing, we are interested in hearing of the crisis, and we are interested in hearing of the causes of the crisis, we are interested in the future. We are also interested in the particular relationship of the farm policy that Congress will determine with the farm bill and the future of the Farm Credit System. It will be interesting to see which commodities or which type of farmers nationwide are in worse condition than others financially. It may well be that there will be geographical aspects of it.

We have received testimony before this committee that in order for the farmers to come out of the present crisis that their income has to be increased over the next several years from 10 to 20 percent. Of course, that cannot be done by Government, but it can be done, perhaps, with a better overall policy.

So, I think the interrelationship is important as we go into this subject. We ought to profit from history.

The Chairman. Senator Harkin.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA

Senator Harkin. Thank you, Mr. Chairman.

I also would like to ask that my statement be submitted in the record,[2] and I just want to make a few comments here today.

I was reading over the first page of Governor Wilkinson's testimony, and it seems to me the first page sets a bad tone for what may come after in the next 100 pages, or however many are there.

The Governor says that "There are three areas of action necessary," in his opening paragraph, but in each of those areas, he does not mention at all increasing income to farmers as one of the areas of action that must be taken to solve the credit crisis.

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[1] See p. 215 for the prepared statement of Senator McConnell.

[2] See p. 216 for the prepared statement of Senator Harkin.

In the next paragraph, he says "a confluence of events and circumstances beyond anyone's control." Now, that is nonsense. We have demonstrated time and time again that if we here in Government take concerted action and work together, we can address the problems that were created by Government—overvalued dollar, high interest rates, loss of exports. These are all caused by Government policies. Government policies can rectify those.

So these events, these things that are happening in agriculture now, are not beyond our control. They just mean that we have to work together and get these solutions through the corridors of power here in Washington.

He said one thing, though, that I do agree with. He said that, "The prospects for near-term improvement in the economic decline in agriculture have disappeared." That may be true. As I see the development of the farm bill on the Senate floor and what happened in the other body, it looks as though, as my colleague from North Dakota said, we may be facing in the next 2, 3, 4 years, declining incomes for our family farmers.

If that is true, then what we are about here is of no avail. It is like everyone always talks about the *Titanic*. I would put it in different terms. The Farm Credit System coming here and asking for a $6 billion bailout is like a boat with a hole in it, and they are coming and asking for bailing buckets. You have got to patch the hole first. We can keep giving them bigger and bigger buckets, but that is just throwing taxpayers' dollars away.

So in a way it may be true. If we are going to pass a farm bill that decreases farm income, then nothing we do here is going to solve the credit crisis. It may patch it for a while, but it will do nothing in the long term.

Finally, I was just looking at Mr. Tucker's testimony. He lays down some principles for seeking Federal assistance. But again, I think Mr. Tucker, with all due respect, misses some very salient points. First of all, the first and most important principle, for any kind of Government assistance to the Farm Credit System has to be farmer first. The aid and assistance has to first go to the farmers to get their income up so they can pay their debts and not be forced off their land.

The second principle, I think we have to have in any kind of assistance to the Farm Credit System must be to not take title to the farmers' land. Title must be left in the farmers' hands and not taken away.

The third principle, I think, is that it must be broad based. As Senator Boschwitz has so ably pointed out, it is not just the Farm Credit System holding all this debt; there are a lot of other entities out there, too. We have a lot of banks in my State, independent banks, private banks, who are holding a lot of that debt. They cannot be left on the outside of this, either. Plus, as Senator Boschwitz has pointed out, a lot of this long-term debt is held by individuals. What about those individuals who are holding these bad loans right now? Are we going to say to them, "You are outside, too"?

They lent money, just like the Farm Credit System and the banks, to people who wanted to engage in agriculture.

So it must be broad based. It must cover not only the Farm Credit System, but also individual banks and private individuals.

The fourth principle, I think, is that land prices must be stabilized. We must prevent the Farm Credit System, the banks, and the regulators from further devaluing the land that is now held out there.

The fifth principle, I think, that we ought to adhere to is that we should not require the establishment of any new Government entities. We have enough Government entities right now to take care of it; we do not need a new bureaucracy to take care of it.

And last, most important of all, all parties must contribute to the solution—Government, lenders, and farmers—all must share in the burden of solving this problem.

But quite frankly, again Mr. Chairman, we must seriously address the credit crisis. It is real, and it is there. But if we try to do it by just putting money into the System without trying to get the farm income up, then we are just going to be throwing more taxpayers' dollars away.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Now, we will go to the witness list. We have a total of five. First, we will have Governor Wilkinson, of the Farm Credit Administration, and I would ask him to sit here.

Subsequent to his testimony, we will have Mr. Tucker, Mr. Roll, and Mr. Swackhamer; and then we will have Frank Naylor.

Senator Zorinsky and I have discussed how to proceed, and the Chair suggests that we let each of the witnesses make his statement, and then we will go to questions. I would urge Senators to make notes for specific witnesses in terms of questions. I count nine Senators, unless one has left or another has come, and I suggest the first round of questions be limited to 7 minutes.

Governor Wilkinson, you may proceed.

STATEMENT OF HON. DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION

Mr. WILKINSON. Thank you, Mr. Chairman, members of the committee.

I am Donald E. Wilkinson, Governor of the Farm Credit Administration, the regulator of the privately owned Farm Credit System.

I have behind me, and I think you may want to be able to identify them, Senior Deputy Governor, recently from the Federal Reserve System, Dr. Marvin Duncan; chief examiner and head of the supervision program of the FCA, Larry Edwards, and general counsel, Fred Medero.

I have a feeling that with the very informed reports and questions that I know are coming, this Governor may not be in a position to answer all of them.

I have presented to you, members of the committee, in the blue folder, very lengthy testimony, and certainly I have no intention of covering all of that. I would like the privilege of having that introduced, Mr. Chairman, and summarizing as rapidly and briefly as I possibly can.[1]

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[1] See p. 225 for the prepared statement of Governor Wilkinson.

The CHAIRMAN. Without objection, so ordered.

Mr. WILKINSON. It has already been stated here, and I wish to emphasize, that the financial condition of the Farm Credit System is critical. But I would like to emphasize that the Farm Credit System is not at this time insolvent.

I have always couched my terms in an 18- to 24-month period. And it has been our feeling as a regulator and as one accountable to this committee that we should not wait until total insolvency before we come to the Congress to present a plan which may be needed at some future date.

It is correct, as Senator Harkin has indicated, that I am here to discuss three specific areas. But before doing that, let me make sure that the members of this committee understand where I am coming from, because the very first and most important part of this entire discussion is the one that has already been stressed. That is that the basic problem, a very basic problem, is still one of the farm economy—its cash-flow problems, its commodity problems, the international market environment, and the hazard of losing even more marketability of American products in the world because of the lack of competitive pricing.

I am not the Secretary of Agriculture, but I have the same concern as everyone around this table regarding the improvement of the income situation, the general economy.

Credit will not do that. I come to you, members of the committee, as the Governor of the Farm Credit Administration, which is responsible for supervision, examination, and regulation of this System. My comments are therefore cast in that particular light.

Incidentally, I am not here, despite perhaps what the press may have indicated, asking for a $6 billion bailout of the Farm Credit System. There are some very specific things in my testimony that I think will separate us from that concept.

Let me, then, hit three very important parts of this presentation, so that you will know where we are coming from.

Yes, it is necessary to strengthen the responsibility and the accountability of ths regulatory agency, and we are asking and have asked prior to this time for expanded FCA enforcement powers that clearly define its role as an arm's-length, independent Federal financial regulatory agency.

Second, a mandate that the Farm Credit System engage in self-help by pooling and managing its resources and its distress credit.

And third, determine an appropriate level of public sector support for the System based upon the public policy objectives that the System serves.

In our testimony to you, we spent much time and space in documenting the stress facing the agricultural lenders, not only the Farm Credit System, but other agricultural lenders. I will not review that. I will go more directly to the points that evidence that the financial resources of the System are going to be taxed to the limit in living with particular problems. Any prospects for near-term improvement—and I am glad that was cited already—or even a cessation in the unrelenting economic decline in agriculture, have disappeared. We do not see any great areas of improvement before us.

The most recent reports confirm further decreases in export markets, massive surplus production in 1985 and beyond, practically insuring low commodity prices. We also see continued downward spiraling of collateral values. This is a great concern to us—the land value situation, and what can be done to stabilize it—and the prospect of substantial distortion in land prices from excess offerings as large groups of distressed farmers and their lenders attempt to restructure the financial situation.

I would like to stress one particular point here, because it addresses itself to the concerns many have expressed, including Senator Harkin's question as to, "Governor, where were you?" Several others have asked that.

We are dealing with such a dynamic, fast-changing situation in agriculture, it is extremely difficult for any lender, and even the farmer himself, to know what his financial picture is today. Let me cite a very specific reason.

Between 1981 and 1985, U.S. farm real estate values declined $151 billion. Over $100 billion of that drop occurred in the last year. It is changing so fast. This erosion of real estate values greatly reduces the ability of lenders to collateralize loans to cover cash-flow shortages. The loss of collateral values also explains perhaps more than any other factor why farm borrowers and their lenders now face their most serious crisis since the Depression, and why this has come upon us so fast.

The effect of this on the Farm Credit System in general, and specifically upon the Federal land banks which, as has been pointed out by Senator Boschwitz, have 43 percent of the farm real estate debt load, is particularly profound.

Department of Agriculture figures show that about $4 billion of the land bank debt is held by operators with debt-to-asset ratios between 70 and 100 percent, and negative cash-flows. Three and one-half billion of it is owed by insolvent operators. That is out of the land bank portion alone.

Senator Boschwitz. State those figures again.

Mr. Wilkinson. Yes. The U.S. Department of Agriculture showed that about $4 billion of the Farm Credit System's land bank debt is held by operators with debt-to-asset ratios between 70 and 100 percent and negative cash-flows. And $3.5 billion of that is owed by insolvent operators—$3.5 billion of it.

Now, if these land values should continue downward—and we do not at this time see any stabilization of land values even in Senator Harkin's State where the dramatic decline is so obvious—we do not see any stabilizing within the next 2 to 3 years. FCA estimates an accumulative total of $13 billion of System loans may become nonaccrual, nonpaying, by the end of 1987.

That, members of the committee, is where we come from in this 18- to 24-month real crisis timeframe.

Senator Boschwitz. What does nonaccrual mean?

Mr. Wilkinson. Nonaccrual means nonpaying, no principal, no interest being paid, Senator.

Given past collateral recovery rates and future economic forecasts as a basis for loss projection, the restructuring and the liquidation of that $13 billion in loans may very well result in chargeoffs of $6 billion before year-end 1987. As a matter of fact, $3 billion of that is now already identified.

Potential losses of this magnitude threaten the financial viability of the System as well as many commercial banks. This is why contingency plans for assistance must be put in place at this time, and the key word there is "contingency."

Let us look ahead, then, based upon our agency's analysis of the current and projected financial condition of the System. Parts of the System are already nonviable—"parts" meaning production credit associations, certain land bank associations, perhaps even some of the 37 banks.

The System's competitive position may be lost well before damage is really reflected in its balance sheet. This is true because any amount of capital is adequate only so long as investors in System securities think it is. A very important point. This is true only because any amount of capital is adequate only so long as investors stay with and have confidence in farm credit securities which are sold on the money market.

Adverse trends in financial ratios are likely to result from continued deterioration in the agricultural economy, additional loan losses, loss of System's ability to attract financially sound borrowers.

These trends, then, members of the committee, threaten the System's ability to continue to sell securities well before capital is lost. The System would likely be unable to fund itself and yet retain substantial financial resources, if the financial markets lose confidence.

The effects of a loss of market confidence would be devastating. The System would truly have a real liquidity problem. Financial markets will be impaired with major additional costs being borne by other agency entities because they, too, share in this agency market and go to the same investment community.

I would also point out here that commercial banks are deeply involved in what happens to the Farm Credit System, not because of their role in sharing lender responsibilities in rural communities, but because commercial banks hold 40 percent of farm credit securities.

Solving the problem? As I mentioned at the beginning, there are three actions which we would urge for your careful consideration.

No. 1 is to expand the FCA's enforcement powers, and I would like to go directly to that. The Farm Credit Administration must be more clearly defined as an arm's-length regulator. There are four points to this proposal.

One is that it must have authority to improve the checks and balances on the System's own banks and associations. This would require the Farm Credit Administration to assume direct responsibility for examining and supervising all System institutions. The policy in former years has been to use the authority to delegate some of that credit review function. We are recommending that this be changed.

We believe this is a proper role as a new and third-party removed financial regulator. Recent experience raises serious questions regarding the reliability of bank credit reviews in stressful conditions—and several of you have referred to that.

The second part of increased authority deals with new intermediate enforcement authorities, which Senator Zorinsky earlier this year gave consideration to and introduced in the form of a bill, and which we reviewed in considerable detail before the Subcommittee on Agricultural Credit and Rural Electrification, Senator Hawkins' subcommittee, on April 24.

The present enforcement tools available to FCA are inadequate to ensure the safety and soundness of the financial institutions which we are accountable for under the act of Congress.

We recommend the enactment of legislation establishing intermediate enforcement authorities for FCA comparable to those possessed by the other Federal financial regulatory agencies. These authorities will permit FCA to stop or to alter a course of action that we as the regulator believe is unsafe, unsound, threatens the strength and stability of the financial institution, or violates the law or the rules or the regulations.

Specifically, we request that FCA be granted authority to issue cease-and-desist orders; removal or suspension of officers, directors, or other persons participating in the affairs of institutions, and the imposition of civil money penalties should they be necessary. These authorities will be exercised by this agency pursuant to statutory provisions requiring that a notice and an opportunity for a hearing be provided to the affected parties. If an order is issued, the affected party could also exercise rights to judicial review.

Senator BOSCHWITZ. This is still FCA?

Mr. WILKINSON. This is still FCA, new authorities.

The third part of that would be increasing the discipline and the accountability upon the Farm Credit System. Shareholders and investors have a right to accurate and timely information regarding the performance and condition of System institutions. Through appropriate disclosure and clear lines of accountability, the markt and shareholders can effectively discipline System institutions.

FCA has proposed regulations to increase the responsibility of the System in disclosing adequately to the investment community and to the farmer-shareholders the situation of the System.

Finally, and the fourth point, still under FCA authorities, is an interesting one, because as we ask for authority to be a proper regulator, we are proposing a number of amendments to delete certain specified functions that are not consistent with that new role as a financial regulatory agency, and can be more appropriately handled by the private system itself.

These amendments specify that when FCA is required by statute to approve transactions or activities, such approval can be given through regulations.

This, then, is a summary of four basic areas of improving the role of the regulator, which you are properly holding accountable, whether it is past years, today, or as we move on into the future.

Let me now, then, go to proposal No. 2 after we leave the regulator, and we ask ourselves how can the Farm Credit System help itself to solve its problems as we see it as their regulator.

We have already talked about losses growing rapidly, threatening to overwhelm the substantial reserves which are still in the System.

We propose that within the Farm Credit System, not a new Government entity, that there be the Farm Credit System capital corporation and that it be granted statutory authorities to implement self-help efforts. This would be capitalized by System funds, staffed by highly competent workout specialists. The Capital Corporation's job will be to work out troubled System loans in a businesslike manner.

This approach will allow the attention of the banks and the associations bank in the rural areas where the action is to return to the business of making sound credit available to those farmers, ranchers, and their ag cooperatives.

There are four key aspects to this specific proposal: One, it mandates that a System pool be established of the capital now within the System; two, it permits the System to pool the distressed loan assets; three, it facilitates the restructuring and disposal of distressed assets; and four, it permits effective management of the System's capital and any Federal assistance which may at some time be available.

These authorities would be carried out under the supervision and control of FCA, as it does with the other parts of the System.

With these parameters, we believe that the System can better manage its own problems and that the Farm Credit Administration would have the authority to intervene when necessary to protect public interest, including farmers as well as investors.

Let us now, go to the third point, the public sector support. What is our expectation of any kind of Government involvement in this particular situation?

The decision of how much Federal financial assistance to provide the Farm Credit System is one that can only be made by you who are Members of Congress, and of course, by the administration, based upon the public policy objectives you wish to have the System serve.

FCA's responsibility is to recommend what it believes to be the most prudent course of action to preserve the essential elements of the Farm Credit System so that it may be there to provide essential credit to farmers and ranchers. And may that always be our point of emphasis—service to the farmers. It is only a mechanism, a vehicle, to provide that.

We, therefore, will outline for you three alternatives that we have given very serious consideration to. We assume in each of these alternatives that Congress will have acted to grant FCA its additional authorities and clarify its arm's-length role as a regulator, and that Congress will mandate that the System make the maximum use of its own resources by augmenting the role, as I have indicated, of the Capital Corporation.

No. 1 alternative is no financial assistance.

Now, we felt we had to review this with you, because some may very well raise that question. This approach at best will increase the System funding cost as investors demand an even higher risk premium on its securities. And we have seen this happen over the last several weeks. At worst, this proposal will cause the ultimate liquidation of the farmer-owned Farm Credit System.

From a borrower's standpoint, it increases the uncertainty, No. 1, of credit availability, and No. 2, it raises the prospect of loss of the borrower's own investment, which we refer to as B stock.

It increases upward pressures on interest rates by no action of the Congress, and downward pressures continue on land values.

It also places tremendous pressure on the System institutions to liquidate and dispose of its assets to generate cash to cover maturing obligations.

Alternative 1: No financial assistance.

Alternative 2: A backup line of credit. This alternative is intended to provide the Farm Credit System with a backup line of credit from the Federal Government that can be drawn upon as a revolving fund. And we have recommended that it be capped at $5 billion, not $6 billion, but by being a revolving fund. As a line of credit, it can provide, I think, essential assistance as needed.

We would recommend the use of a modified Governor's revolving fund, which is already in the statutes, but that it not be triggered until the System's resources have adequately been committed under some rather carefully defined viability standards. This approach will negate many of the undesirable effects of the first alternative.

We believe that a backstop concept will provide the necessary reassurance to the financial markets to ensure the continued availability of funds. Members of the committee, I cannot overstress the impact of uncertainty in the market and the direct cost to the farmer via increased interest rates. We witnessed it yesterday, as there was a hint that the Federal Government may step forward. And we went to market yesterday with $1¼ billion estimated to have a spread of 125 basis points, and the actual spread was down to 85. The hint of some kind of Federal involvement is what the marketplace is looking for.

This approach, too, with a backup will keep the desirable level of pressure on the Farm Credit System, which we believe is important, when you look at it at the cost of the taxpayers, to establish greater efficiencies, maximize the use of its own resources in dealing with the problems

This alternative should also stabilize interest rates on a System basis reducing them for some institutions; alleviating borrower concern over the loss of actual source of credit; encouraging a more orderly process for handling forebearance, managing distress situations. Under this alternative, no taxpayer funds would be committed until the clear need to do so was evident.

Alternative 3: Up-front financial assistance. This alternative provides direct, up-front financial assistance, combined with all of the other aspects I have talked about, including the contingent line of credit.

We in the Farm Credit Administration are concerned with the immediate budgetary impact which this committee and this Congress must be concerned with, and this approach would impact upon that by causing now an appropriated use of x millions of dollars.

We are also concerned that this alternative would very possibly reduce the the mandate upon the System to increase its own operating efficiency.

In conclusion, members of the committee, we recommend the following actions:

One, Grant FCA the authority to be truly an arm's-length regulator;

Two, Mandate that the System use its own resources by establishing via statutory authority for the Farm Credit System Capital Corporation and

Three, Establish an adequate backup line of credit to be drawn upon as the need is demonstrated.

Madam Chair, thank you very much.

Senator HAWKINS. We will now hear from the panel.

Senator BOSCHWITZ. Madam Chairman, cannot we ask questions of Mr. Wilkinson now?

Senator HAWKINS. Senator Helms said he would like all three to give their statement and then ask questions.

Senator BOSCHWITZ. Madam Chairman, that was not my understanding of what he said. It was not clear to me what he said.

Senator HAWKINS. He is not here. Let us decide what we want to do.

Senator BOSCHWITZ. Let us ask questions. [Laughter.] There is going to be so much additional testimony that it will not be fresh in anybody's mind.

Senator HAWKINS. The understanding is that we will have 7 minutes apiece to question each witness.

Senator Boschwitz, I will allow you to go first.

Senator BOSCHWITZ. How much is the loan demand of the Farm Credit System at the present time in the farm land banks and in the PCA? What is the loan demand by farmers?

Mr. WILKINSON. The volume outstanding, Senator?

Senator BOSCHWITZ. No; are they coming in? Do they want to buy land or what?

Mr. WILKINSON. I understand your question now. What is the interest of stockholders and farmers in securing loans?

Senator BOSCHWITZ. Yes.

Mr. WILKINSON. In the land bank it is very little. Farmers are truly tightening their belt. There is a paydown, Senator Boschwitz, in the Farm Credit System.

Senator BOSCHWITZ. What is the cash-flow this year? How much do you have coming due this year in the fiscal year that just began?

Mr. WILKINSON. If I remember, we have between now and yearend——

Mr. EDWARDS. Yearend, $9 billion.

Senator BOSCHWITZ. $9 billion of securities.

Mr. WILKINSON. Between now and yearend, Senator.

Senator BOSCHWITZ. What is your cash position right now?

Mr. WILKINSON. Cash position right now, Mr. Edwards?

Senator BOSCHWITZ. Why does not the chairman of the board know what the cash position of the bank is?

Mr. WILKINSON. The Farm Credit System has $9.2 billion in its financial situation.

Senator BOSCHWITZ. You are now talking about its net worth.

Mr. WILKINSON. I am talking about its net worth, yes, sir.

Senator BOSCHWITZ. But how much money?

Mr. WILKINSON. About 4½ of that is owner equity.

Senator BOSCHWITZ. How much cash do you have in the Farm Credit System?

Mr. NEEDHAM. There is $5.5 billion in cash and convertibles.

Senator BOSCHWITZ. At the present time. What about the year following? What is the number of securities that you are going to have to renew at that time?

Senator HAWKINS. Will the gentleman answering questions please state his name and his title for the record.

Mr. WILKINSON. Dick Needham, financial analyst for the Farm Credit Administration, Madam Chairman.

Senator HAWKINS. Would you answer the questions if you are going to be the one to answer?

Senator BOSCHWITZ. The question is, Do you have adequate cash-flow to take care of your securities in view of the fact that you have a low loan demand?

Mr. NEEDHAM. The cash-flow is basically in hand. There is a balance of securities, but basically the present loan paydown, the general cash-flow is in securities.

Senator BOSCHWITZ. The general cash-flow should be pretty good at the present time. The resources continue to be $9.2 billion. You, Mr. Wilkinson, talked about getting that into the Capital Corporation which, I believe, is in Wichita and not in Denver as I previously said. How much of that do you think you can take into the Capital Corporation at the present time?

Mr. WILKINSON. I think if you take that which is not in the form of class B stock, it can be assembled as a central pool. That would be $4.5 to $5 billion; $5 billion our analyst indicates.

Senator BOSCHWITZ. And you say that you are going to use certainly all of that if you have $13 billion of nonaccrual loans, but, of course, there is a good deal of value supporting some of those nonaccrual loans.

You pointed out public sector support, a backup line of credit which is second. Can that backup line of credit be provided by loan guarantees for a period of time so that we do not have to make an appropriation?

Mr. WILKINSON. A loan guarantee would be a valuable asset to that backup line of credit, and perhaps would delay or perhaps at least in the next few years not make necessary the use of that particular line of credit which is waiting and sitting there.

Senator BOSCHWITZ. So that it is possible that we do a guarantee type of system, and some of your suggestions of taking the bad loans, the nonperforming loans or accrual, as you call them, into a central Capital Corporation. similar to what I suggested——

Mr. WILKINSON. Yes.

Senator BOSCHWITZ [continuing]. If the market is waiting for a hint of some kind of Federal involvement as you say, I think that they certainly can take this hearing in the general sentiments of the Congress as strong hints in that case.

Personally, I would rather see a guarantee rather than a revolving fund that would require an outlay, so that it would seem to me that the affairs of the Farm Credit System can be taken care of for quite some time through its own cash-flow, particularly if there is a low demand for new loans and repayments are being made. I think that repayments have exceeded new loans by $4 billion in the last few months, is that correct?

Mr. WILKINSON. Yes, sir; that is why we are indicating 18 to 24 months, Senator. There is another aspect here, too, and that is the ability of this Capital Corporation to be able to handle the assets which it acquires in a constructive, productive manner, and if there is a stabilized agriculture economy, then that will be an improved situation as well.

Senator BOSCHWITZ. You were indicating that the situation is so dynamic and fast changing earlier on that you were unable to give us a proper type of statement, a proper type of status report on the Farm Credit Administration. I would assume that at any given moment you can tell us what your assets and your liabilities are and when those assets and liabilities are due.

Mr. WILKINSON. The Farm Credit Administration as a regulator makes quarterly reports to the Congress. The last quarterly report was, of course, September 30. The Farm Credit System is also providing sound information for the investment community based on those reports and other information. This information has to come from the lending institutions themselves.

So on an hourly to hourly basis or even daily, we do not have the information sitting in FCA, sir.

Senator BOSCHWITZ. I would like to ask Mr. Wilkinson to provide the committee a list of your securities when they will mature, and also a projection of your cash-flow, the incoming cash-flow of the entire system. You can break it down by systems if you like.

Senator HAWKINS. To follow up on that question, Mr. Wilkinson, were those quarterly reports certified by an independent auditor?

Mr. WILKINSON. No; these are the reports of the regulator which come from FCA. The reports which the System—the Farm Credit System—is providing to the financial community will have certification by the public accounting firm, and you will be hearing from them in the next group.

Senator HAWKINS. But that has not been a practice in the past?

Mr. WILKINSON. This is the first year that the banks of the Farm Credit System will have a public accounting report.

Senator HAWKINS. How long has that been in existence? That custom of not having a public accounting report?

Mr. WILKINSON. The banks, of course, have normally had the regular examinations of the Federal regulator, and that is our responsibility. Certification to the investment community is a different issue, and at this time, the banks with our recommendation, as of 1½ or 2 years ago, have retained a public accounting firm to provide a certified report to the investment community.

Senator HAWKINS. But they have never done that prior to the last recommendation by your agency?

Mr. WILKINSON. Their reports were based upon the examination by the Farm Credit Administration, Madam Chairman.

Senator HAWKINS. Could you explain to me why you, as the chief regulator, gave an interview to the Wall Street Journal regarding the financial soundness of the Farm Credit System rather than coming to this committee?

Mr. WILKINSON. Because I think there is a misunderstanding as to what was given to the Wall Street Journal at a given time. We had come to the committee on April 24, chaired by you, evidencing our concern regarding the serious, growing concern in the total agriculture credit picture.

I was preparing to go to my Federal board in September with a report indicating that we had to begin developing a contingency plan.

Senator HAWKINS. And how did Mr. McCoy get your attention to give him this information rather than to the committee?

Mr. WILKINSON. Mr. McCoy had, as is available to any reporter, received the agenda of the Federal Farm Credit Board. That is required by the Government standards to make that agenda available, and on that agenda was the indication that the Federal board in September would be discussing and receiving a proposal from me regarding contingency planning or preparation to try to take care of some of the concerns of the Farm Credit System.

That reporter had that agenda, noticed it on there, called me to confirm that it was on there, and then put that story together which he had been working on for many months. Many of the issues in there cannot be credited to this Governor. I only confirmed that the agenda item was there.

Senator HAWKINS. As a result of this story, could you tell me when you did go to market? Was it the next day or the week after? Was it September 20 that you went to market?

Mr. WILKINSON. The System went to the market with its regular monthly issues, and your question is what was the impact?

Senator HAWKINS. Yes.

Mr. WILKINSON. And the impact was very serious as it would be whenever the financial community was alerted to the growing concern of the regulator.

Senator HAWKINS. Yes; but my point is that you are stating in your answer to Senator Boschwitz that with the hint of Federal assistance which has been talked about in the press in the last week or so that when you went to market yesterday that you had a better reception just with the hint of it, not with the promise of it.

But my question to you is: In September, how many basis points did it cost and what were the ramifications when you went to market in, I think, it was September 20? We were tiptoeing around here trying not to hurt your offering——

Mr. WILKINSON. That is right.

Senator HAWKINS [continuing]. Because we understood that the first Wall Street Journal article had already hurt your offering. No Senator on this committee wanted to be responsible for having that offering go up. So how many basis points was the difference?

Mr. WILKINSON. Madam Chairman, I do not remember the specific basis point spread that would have been generated at that time.

Senator HAWKINS. It was somewhere in the range of 65 points. Was it somewhere in the neighborhood of 65 points it went up? And that you could not sell any issue with a life longer than 6 months?

Mr. WILKINSON. We have determined at the present time that it best be within the 6-month range.

Senator HAWKINS. But that was determined by the buyers.

Mr. **Wilkinson**. It was determined by the funding corporation which is part of the Farm Credit System analysis of what the market will be able to take.

Senator **Boren**. Madam Chairman, I appreciate the question you just asked. I think what we have a right to know is why have we been strung along for weeks and weeks and being told we cannot possibly tell a Member of the U.S. Senate or come to testify before this committee about the situation in the System. It might hurt the market.

And then, on the other hand, why is it better to have a public interview with newspapers rather than informing this committee even on a confidential but official basis of the problem?

How do you justify going to the newspapers, endangering the credit market, when there is a refusal to come before this committee under the guise that it might hurt us if it became public about that situation?

How do you justify that as a public official, or are we being told that this is a totally independent organization that feels no responsibility or accountability to this committee or to the Congress?

Mr. **Wilkinson**. May I respond?

Senator **Hawkins**. Surely.

Mr. **Wilkinson**. No, we do not believe that although an independent agency that we should ever have that degree of independence, Senator Boren. We were attempting to keep the appropriate committees and their staffers informed. We had, I think, evidenced very serious concern in our April 24 testimony. I felt that my first and immediate responsibility was to the policy board over the Farm Credit Administration which was the body that I was reporting to, but as we had done that, we had attempted to provide certain information as the situation was worsening.

Senator **Boren**. Sir, in the April hearings here, where did you point out the same sort of concerns that you pointed to the Wall Street Journal?

Senator **Boschwitz**. I do not think Mr. Wilkinson has answered your question why he chose to go to the Wall Street Journal.

Senator **Hawkins**. Let us have the first answer first, Senator Boren, for the record.

Senator **Boren**. Why did you choose the Wall Street Journal over Senate Agriculture, not that I dislike the Wall Street Journal?

Mr. **Wilkinson**. May I again emphasize, as I have attempted to explain to Senator Hawkins, that the only indication that I gave to the Wall Street Journal was an acknowledgment that on the agenda of the Federal Farm Credit Board meeting at that particular meeting was an agenda item dealing with contingency planning for Federal assistance, contingency planning, not that it was going to happen, not that it was that eminent, but that contingency planning was based on some of the dramatic changes that had taken place, including that $100 billion drop in land values, including the USDA's report regarding commodity production, including the loss of foreign sales, all of it beginning to build up.

We were taking it to our Federal board. All the Wall Street Journal had was the agenda of the Federal board.

Senator **Hawkins**. Let me interrupt you, Senator Boren. But in the September 4 article that appeared in the Wall Street Journal.

But in the article, and a lot of us are faced with articles that are not accurate when we are quoted. However, we tend to believe them if it is about somebody else. In this article I have before me, dated September 4, "Farmers' troubles have outflanked the Systems' worst case projection and left it floundering in billions of dollars of loans that are either uncollectible or will be within months," and then the article quotes you:

> We have come to realize that the deterioration in agriculture has grown beyond the ability for the Farm Credit System to handle it. We cannot absorb the losses we face.

Mr. WILKINSON. Explaining the reason why we were taking a plan to the Federal board.

Senator HAWKINS. I understand. But now to follow up Senator Boren's question, rather than making this statement to the reporter at the Wall Street Journal, would it not have been prudent to pick up the telephone and call this chairman of the Farm Credit Subcommittee or Senator Boren, who is the ranking member, or somebody on the Hill?

You have just made a statement on the record that just the suggestion of Federal help helped you in your bond sales this week. However, I am here to tell you that if you want to think this through, you know, even best case, had you said somewhere in here "I have talked to the committee," or "we meant to talk to the committee about the crisis," I guarantee you that would have prevented you from having so many basis points extra for the September 20 offering of FCS securities.

Every basis point is $300 million in higher interest rates to the farmers. Now, Senator Boren and I discussed this almost on a daily basis as the chairman and the ranking member. "Have they talked to you? Will they bring you some papers? Did they have anything to say?"

And we were as helpful as we could be not to say that any Senator on this committee was responsible for those basis points going up even 1 basis point.

But it is incredible for this chairman to read this statement, and then in answer to Senator Boren's question, "He called me up. He saw my agenda, called me up and I revealed all this but I did not have the time nor the trouble nor the responsibility to call the Senators who are going to give you a hint of help or slam the door or maybe both."

So I still do not think there is an adequate answer in the record to Senator Boren's question why we were not alerted on September 3. I must tell you, as a responsible Senator, had I had an interview on the 3d, I would have called the Senators on the 3d and said, "Tomorrow you are going to read a story and I want to tell you how it happened." But that was not done, as far as I am informed. I have asked most Senators on this committee.

Excuse me, Senator Boren, for interrupting you.

Senator BOREN. Madam Chairman, I really interrupted you on your line of questioning.

Senator HAWKINS. Go ahead.

Senator BOREN. The press release issued by the Farm Credit Administration talks about how well the committee was informed in a press release put out by the Farm Credit Administration August 1 with a statement attributed to Governor Wilkinson.

"The Farm Credit System has the financial and human resources to handle its own problems without Federal assistance if it makes proper use of those resources."

I think you can see why, then, we were so astounded to learn from the Wall Street Journal a total reversal of that without any intervening notification to the committee.

Mr. **Wilkinson**. I will respond to your question, Senator Boren, and to Senator Hawkins' question by saying, as we look back upon it now and as we reviewed the sequence of events with our own board, the answer is "Yes," it would have been prudent to have called Senator Hawkins and you, Senator Boren, and Senator Helms, and I did not do it.

Senator **Boren**. We were working at that very time on trying to get the farm bill out. We had the farm bill deliberations going on.

Senator **Hawkins**. I think Senator Grassley just walked into the room. Would you not like to sit at the table here and raise hell like you usually do? [Laughter.]

Senator **Harkin**. I do not know if I would let her get by with that, Chuck. [Laughter.]

Madam Chairman, if I might just respond to that?

Senator **Hawkins**. To what?

Senator **Harkin**. If I might just respond to that comment by my esteemed colleague and friend from Iowa. He does not raise hell. He just tells the truth and the people think it is hell when he tells the truth.

Senator **Hawkins**. He makes it a lot hotter for all of us. He is our good friend.

Senator **Boren**. Madam Chairman, I interrupted your questioning. I had a couple of others.

Senator **Hawkins**. This is a joint effort. I would like to just ask one more question. Then I will give the 7 minutes to Senator Boren.

Is it true that local land bank associations and FCA's are examined by the district banks rather than by the regulator?

Mr. **Wilkinson**. Both of us have had the responsibility. The banks, as the supervisory agencies, have had responsibility of reviewing the credits and the business functions of those associations.

The law requires the Farm Credit Administration to have routine examinations of those associations. In my testimony which I have already presented to you, I indicated that this will now be the responsibility of the regulator to conduct the examinations of all of the institutions of the Farm Credit System.

Senator **Hawkins**. Well, I said in my opening statement, How can it be that such a large lending institution does not know its financial condition?

Mr. **Wilkinson**. And the answer is because it is such a dynamically changing situation as I indicated in land values and knowing what the collateral value of those loans is is very difficult to know what the repayment capacity of that borrower is, and it is changing daily.

Senator **Hawkins**. Can you tell me why we had to delay congressional hearings so that the System could take stock of its position?

Mr. WILKINSON. This was requested initially by the administration. It was concurred in by this Farm Credit Administration. It was concurred in by the System in an effort to be able to use the third quarter information which was coming in at that time, the September 30 figures, so that we would not have to be sharing with you the June 30 information.

Senator HAWKINS. Senator Boren, would you like to take your 7 minutes?

Senator BOREN. Thank you very much, Madam Chairman.

In September, Governor Wilkinson, I wrote to the FCA asking certain information, total acreage involved in the foreclosures by State, dollar amount involved in foreclosures by State, the borrowers involved in foreclosures, liquidations, or bankruptcies because we had seen statistics.

I was told that the FCA formally questions these numbers and volumes on loans, but since 1983, this information is no longer collected by the FCA. I wondered why that is.

Mr. WILKINSON. You are facing the reality that, in one case, you are dealing with a private financial institution, the banks and the associations themselves, which have that information at their resources.

We, as the Federal regulator, have not collected all of that information on a timely basis as part of our reports.

Senator BOREN. How can you do an effective job of regulating if you are just relying upon them to provide this information?

Mr. WILKINSON. We are still examining and getting that kind of information, Senator Boren, but we do not have it available that rapidly per your request, sir.

Senator BOREN. I noticed in this same period of time it was apparent we used to collect this information that in the operating expenses of FCA, while apparently you have not expanded your operations, in fact, possibly narrowed the scope, and gone from $10,500,000 a year, or 5 years ago, to $19,646,000 last year, an 86-percent increase, almost 87.

How can you justify that kind of administrative cost increase during this period of time and how is your budget funded? Is it funded by contributions from member associations?

Mr. WILKINSON. No. 1 is that the employees of the Farm Credit Administration are Federal employees, Senator Boren. I think you will find that there has been very little change in the employment roster, the number of employees which the FCA has had during that period of time.

Senator BOREN. An 87-percent cost increase has been borne by the taxpayers through Federal subsidies.

Mr. WILKINSON. No; not by taxpayers. The allocation of cost is to the System as it is with the other financial regulators.

Senator BOREN. I understand also that the FCA also is set to authorize salary ranges for the executive officers of the regional banks.

Mr. WILKINSON. The word "ranges" is correct. The law itself, Senator Boren, as it is in the present Farm Credit Act, requires that the Farm Credit Administration establish the ranges.

Senator BOREN. Well, I understand the ranges in 1980, for example, for CEO's salaries were $66,000 to $120,000 in 1980, and the authorized range was then adjusted by the FCA to $146,000 to $233,500 in 1985, and that, in fact, salary range was authorized from the President Farm Credit National Corp. in Denver to from $300,000 to $500,000.

Now, given the stress on the farm, how in the world can we justify or can you justify changing the authorized ranges from $66,000 to $120,000 up to a range of $146,000 which is the bottom range even above the maximum in 1980 to $233,000? How can that be justified?

Mr. WILKINSON. There are three points that we would want to mention, Senator Boren. No. 1 is that these are not Government institutions. These are private financial institutions, not unlike the commercial banks in your community.

Senator BOREN. Why should they be treated any differently? You are asking for special capital infusion. Why then do you deserve that if you are not anything but a private bank?

Mr. WILKINSON. Because of special mandate of Congress which grants the authority to the Farm Credit System to make only agricultural loans to a very limited sector.

Senator BOREN. Why did they give you such a mandate when you are going around setting rates of salary ranges like this while you are raising the interest rates to farmer-borrowers that ultimately have to pay these costs?

Mr. WILKINSON. The second point I wanted to make was that these salaries are actually set by the farmer-elected board of directors over each of these institutions.

Senator BOREN. Let me ask you about that. I understand that you have issued regulations that allow the local districts to force—merge local associations—I wonder—you talk about the control by the local people.

How do you think it benefits control by local people? I take the Wichita example where they are now attempting to consolidate all of the 71 local boards, the 350 local elected directors in four States to a board of only 14 directors located in Wichita, KS.

How can you justify, if this is an organization that has a special relationship chartered by Congress, issuing regulations that allow for that degree of consolidation and loss of local support?

Mr. WILKINSON. May I point out, Senator, that the ultimate approval of that plan of Wichita's or Omaha's or any other one depends upon the vote of the stockholders, the owners of the credit insitutions themselves.

Senator BOREN. Is it also true that under the regulations that you have issued that the local existing bank is empowered to move all loans out of any land bank association, all of them to an adjoining bank if the members of that association don't approve it?

They also have the power to deny financial access on an equal interest rate basis to any PCA members that do not want it, is that not true?

Mr. WILKINSON. The basic effort that is being made by the Farm Credit System collectively is to make greater use of the capital resources and the reserves that it has.

Senator BOREN. Is it not true that you say this to the local board—and I have this in writing, that there is authority vested in the regional bank, say in the Bank of Wichita, for example, to say to a local association in X town in Oklahoma or New Mexico or Kansas, "If you vote, members, not to consolidate, all of the loans can be transferred out of your local association"?

Mr. WILKINSON. I think you may want to remember that they are not truly separate, autonomous associations.

Senator BOREN. Well, am I wrong? Is my statement incorrect that that authority exists, that the bank has that authority?

Mr. WILKINSON. No; the bank does not have that authority.

Senator BOREN. There is no authority. There is no one that can move any loans out of a local Federal land bank if that membership votes not to consolidate, they cannot move loans from that association to another.

Mr. WILKINSON. The land bank is the one that makes the loans. It is a different situation than it is when it is a credit bank or the production credit association.

Senator BOREN. Well, I want to get this down because I have it to the contrary in citing the regulations in an instruction to a local land bank where they were told that the authority exists, if they vote against consolidation, that authority exists on the part of the central bank or higher authority—I may be using the wrong technical term—someone else somewhere, can transfer their loans to a neighboring association.

Mr. WILKINSON. Will you permit our deputy governor for supervision who is the one that issued the proposals to answer?

Mr. EDWARDS. Senator, the letter you were referring to is one that was written by the president of the Wichita bank in an association in Oklahoma. His letter is correct insofar as it goes. The agency agreement that exists between the FLBA and the bank technically would probably give them the right to move those loans for cause.

I became aware of the letter you are referring to last week. I obtained a copy of it yesterday. I sent a letter to the president of the bank or the chairman of the board telling him that we did not believe they had that authority unless they could show cause based on the performance of the association and that failure to approve that merger was not cause.

Senator BOREN. So we can be assured that failure to approve the merger would not result in the moving of any of those loans?

Mr. EDWARDS. You can, sir.

Senator BOREN. Is the same thing true with the production credit association? Can they then be guaranteed that if they decline to merge that they will continue to get the same access at the very same rate of interest as other associations that do merge?

Mr. EDWARDS. The fact that an association fails to approve a merger is not a basis for charging them a different interest rate. [See answer to question 4 in letter of November 20 from Mr. Wilkinson, p. 289]

Senator HAWKINS. Senator Boren, your time has expired. We will come back to that line of thought. Mr. Chairman.

The CHAIRMAN. I had to go to the Foreign Relations Committee. We are expected to be in two or three places at one time, and I have not mastered that yet.

It is a cliché around this place to say that we must provide significant help to the farmers in any assistance package for the

System, and I recognize that through maintaining a viable source of credit to agriculture by assisting institutions, we will provide a measure of help.

But I guess the question that comes to my mind is, will it be affordable?

Mr. WILKINSON. Yes; in our proposal, we believe it is affordable when there is, No. 1, no front end money in our proposal. No. 2, that the System is required to use all of its own resources, and we have been discussing the resources that are available.

And No. 3, with the expectation that if it does have to make use of that backup line of credit, that it will be on a concept of repayment. It will be a revolving fund, and we believe that that is a minimal kind of assistance program which will enable the System at least for the next 2 or 2½ years, Senator, to be able to serve its borrowers at interest rates which hopefully will not have the spreads between the Government's cost and the market cost.

It is difficult to respond to interest rates because, as you know the System goes to the money market and has to depend on what is available at the cost to secure sale of issues at that particular time.

The CHAIRMAN. You think it will follow the going rate then?

Mr. WILKINSON. We would sincerely hope that as the cost of money in the money market is reduced that the System will be able to also provide some alleviation of interest at the farmer level.

The CHAIRMAN. What modifications are you going to recommend for the Federal Farm Credit Board?

Mr. WILKINSON. Senator Helms, I have been asked as the chief executive officer accountable to the board to not be involved in any kind of communication regarding the Federal board or its authorities, sir.

The CHAIRMAN. So you do not want to go public right now?

Mr. WILKINSON. I have no authority to go public with any ideas, sir.

The CHAIRMAN. What would be the effect on the cost of farm credit bonds if the Congress were to enact a temporary moratorium on the payment of all Farm Credit repayment?

Mr. WILKINSON. Any kind of a moratorium, we believe, would send a very adverse signal to the investment community, raising the question as to whether those who would be still willing to invest would know that the interest payments and the principal payments coming from this private system would be there to cover the repayment requirements to the investors.

Second, we think and have stressed on many occasions that any kind of a moratorium in agriculture is going to perhaps have a very negative effect in driving other credit sources away from farmers at just the time they need it. We believe that a moratorium of any kind would have a very serious impact, sir.

Senator GRASSLEY. Will the chairman permit me to interject? Iowa has a 1-month experience with that. There is no negative impact. A moratorium under State law.

The CHAIRMAN. Let us talk about real estate values. How will they be affected if, as and when assistance is provided to the Farm Credit System?

Mr. WILKINSON. I think we would stress first that providing some stabilization to land real estate values is a very important thing that has to be done. We believe that providing to the Farm Credit System a line of credit, especially for use by the land bank which holds 43 percent of all of the real estate loans, will enable it to provide a greater opportunity to work with farmers in handling the loans themselves and causing them not to have to so rapidly turn that land onto the open market and just causing greater decline of land values.

We think that the proposal that we have brought to you could have significant impact upon stabilizing land values which, in turn, would not only be helpful to the Farm Credit System and its land bank, but would be very helpful to commercial banks who use land as collaterals for their short-term operating loans.

The CHAIRMAN. Governor, I guess everybody is aware of proposals being discussed concerning restructuring of the Farm Credit System. To achieve those necessary changes in regulation and supervision, is it advisable that we create another entity or substantially restructure the existing one?

Mr. WILKINSON. We would not recommend at this time, Senator, the creation of another entity. That is why, in our proposal, we recommended the use of an existing entity which is known as the Farm Credit Systems Capital Corporation which would be the centralization of the resources and the bad loans and the workout aspects.

That does not say that ultimately there must be some very significant changes in the basic structure of this System, but I do not think that has to be done at this particular time.

The CHAIRMAN. One quick question going back to the original one that I asked about the recommendations that you say you cannot discuss publicly, but as chairman of this committee, I would like this committee to receive some recommendations, and I am sure that you would comply with that, sir.

Mr. WILKINSON. May I clarify? Would this be recommendations regarding a policy board concept?

The CHAIRMAN. Modification of the Federal Farm Credit Board.

Mr. WILKINSON. Modification of the Federal Farm Credit Board, changing role or whatever.

The CHAIRMAN. Yes, sir.

Mr. WILKINSON. You are asking me to respond back to you at a given time after I have discussed it with the Federal Board, sir?

The CHAIRMAN. As quickly as possible, because we have to make our judgment based on all the facts.

Mr. WILKINSON. All right.

The CHAIRMAN. We want to consider everybody's recommendations.

This is especially timely since the Board meets next week.

Mr. WILKINSON. Yes; and we have Board members here in the room, and I think they have heard this. The Board convenes Sunday night and meets Monday and into Tuesday, and I hear you asking would this be a very major item on that agenda and that I report back to you and the committee; yes, sir.[1]

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[1] See p. 290, answer to question 6.

The **CHAIRMAN**. Thank you very much.

Thank you, Madam Chairman.

Senator **HAWKINS**. Thank you.

Senator Cochran.

Senator **ANDREWS**. Madam Chairman, could I ask just one question. My committee is on the floor and I have a debate that I have to enter into over there and I am late.

Senator **COCHRAN**. I will be happy to yield.

Senator **ANDREWS**. I appreciate that. That one question, Mr. Governor, is if this Congress, in its wisdom, puts together a farm price support program that has decreasing supports in the out-years, will that jeopardize further the long-term credit obligations held by the Farm Credit Administration?

Mr. **WILKINSON**. I think, Senator Andrews, as you so well know, decreasing commodity price or price supports is only one part of the picture. What has to be done is to enable the farm community to be able to market its commodity competitively in the world market so that there will be the ability of agriculture to strengthen itself.

Senator **ANDREWS**. Well, you are saying that the change in target prices one way or another has no effect as far as you see it on your loan?

Mr. **WILKINSON**. I am saying it has a significant effect, sir.

Senator **ANDREWS**. In other words, if those out-year target prices are lowered, these long-term loans that the Farm Credit System has will be in greater jeopardy than they are right now?

Mr. **WILKINSON**. Yes; and I have also said there are other aspects to keep in mind

Senator **ANDREWS**. Well, we all know there are aspects. I just wanted to get that simple answer

Thank you, Madam Chairman.

Senator **HAWKINS**. Senator Cochran.

Senator **COCHRAN**. Thank you, Madam Chairman.

Governor Wilkinson, in looking over the proposals that you make in the legislation that has been submitted to the committee, I get the impression that the suggestion is to make the Farm Credit Administration a true Federal financial regulatory agency, am I correct in that first assumption?

Mr. **WILKINSON**. Yes, sir, you are.

Senator **COCHRAN**. At one point in your statement, you make the observation that you have a need to enhance your independence as a Federal financial agency. I wonder how we can, on the one hand, create a new Federal agency and on the other hand, and at the same time, enhance your independence of the Federal Government?

To me, you are independent now. We do not do anything except have an annual hearing and review the status of the Farm Credit Administration. You come every year and testify before the appropriations subcommittee that I chair, but other than that, there is really not much connection, is there, at the present time?

Mr. **WILKINSON**. If I have your question correctly, Senator Cochran, the independence does not deal with the Farm Credit Administration and you the Congress. The independence deals with the

Farm Credit Administration as separate from the Farm Credit System.

And one of the basic problems we face today is that, as some of you may remember, the Farm Credit System at one time was part of the Farm Credit Administration. It was all Government, and there are still those that truly believe that FCA is the home office of the Farm Credit System.

We are trying to separate ourselves, be a true independent regulator, sir.

Senator COCHRAN. So the transition that we are being asked to facilitate is one of creating true regulatory powers, enforcement authorities within the Farm Credit Administration as the administrator and regulator, but to have the System to continue to function as a privately owned group of entities, is that correct?

Mr. WILKINSON. Yes, sir, very properly stated.

Senator COCHRAN. Let me ask you this question. Is there any truth to the charge that the Farm Credit System has been systemmatically pushing off onto the Farmers Home Administration all of its bad loans to help stabilize the System?

Is that self-help in the way that it has been described? Has there been a systemmatic effort to push all the bad loans off onto the Federal Government at the Farmers Home Administration?

Mr. WILKINSON. No; I do not think you would say there was a system wide concerted effort I think what has to be recognized is the earlier point you made that the System is a private institution and that it has to evaluate the creditworthiness and the repayment capacity of those borrowers, and as times have worsened, there have been borrowers who have been unable to secure continuing loans

Now, it was, I think, the expectation that there would be a Government subsidized credit program known as Farmers Home to absorb some of those that come out of the commercial banks and some that come out of the production credit association and elsewhere, and that has been a relationship over the many years.

Senator COCHRAN. There has been about $5 billion in direct lending from the Farmers Home Administration this year to distressed farmers, those who cannot get credit from any other source except the Farmers Home Administration.

But there is, at the same time, a request by the administration that we convert the Farmers Home lending program into a guaranteed lending program rather than a direct program of lending.

What is your reaction to that? Should the Federal Government continue to make direct loans or would it be more appropriate to convert that system or change that system into one of more guaranteed lending?

Mr. WILKINSON. At the present time with the portfolio that the Farmers Home Administration has, I think it will have to continue to have some degree of direct lending, but what faces both the Farmers Home as well as the commercial credit institutions is that there is a group of farmers who are now in the commercial institutions who are going to be unable to secure credit even with the best of workout plans and forebearance that are going to be searching for a home, and they can benefit through a guaranteed program of

Farmers Home working with commercial banks and the production credit association.

Senator COCHRAN. Of the $215 billion in farm debt today, is my understanding correct that you say that about $50 billion of that is debt that is not going to be or cannot be repaid.

Mr. DUNCAN. There is $50 billion of troubled debt.

Mr. WILKINSON. $50 billion of troubled debt.

Senator COCHRAN. That is different from not going to be paid back?

Mr. WILKINSON. Yes, sir.

Senator COCHRAN. Is there a figure you can give us indicating how much of the $215 billion of total farm debt that is going to just absolutely and inevitably be defaulted? Do you have a figure for that?

Mr. WILKINSON. I will ask Marvin Duncan of our staff to comment.

Mr. DUNCAN. I am Marvin Duncan, Senior Deputy Governor of Farm Credit Administration.

About $25 billion of debt that probably is not going to be repaid across agriculture. And I emphasize that this is across——

Senator COCHRAN. Yes, I understand. What percentage of the farm community, number of farmers, does that represent? Is there a way to say that? Is that 5, 10, or 20 percent of the Nation's farmers who are in debt today, who are going to have to forfeit their lands, be foreclosed?

Mr. DUNCAN. It is very difficult, sir, to indicate that, but there is a cadre of farmers who have both negative cash-flow and debt-to-asset ratios in excess of 70 percent, and by most judgments, those farmers are in such deep financial trouble that it is unlikely that they can be salvaged without——

Senator COCHRAN. But you do not have a number or a percentage?

Mr. DUNCAN. My off-the-top-of-my-head recollection is perhaps about 15 percent.

Senator COCHRAN. Thank you very much.

Thank you, Madam Chairman.

Senator HAWKINS. Thank you.

We will go to Senator Zorinsky for his 7 minutes.

Senator ZORINSKY. Thank you, Madam Chairman.

The farmer-borrowers in the Farm Credit System in my State of Nebraska have experienced problems in obtaining information from production credit associations and Federal Land Bank Associations. This is information to which they are entitled as shareholders and borrowers of Farm Credit System institutions. Requests for copies of bylaws have either been unnecessarily delayed or denied to these shareholders. It is apparent that the Farm Credit System institutions could have cooperated with, rather than thwarted, the efforts of shareholders to obtain shareholder lists. They needed the lists to enable them to organize and keep each other informed as to issues of mutual concern.

At what level within the Farm Credit System were decisions made not to gve those lists to the shareholders?

Mr. WILKINSON. Senator Zorinsky, we are familiar with that particular complaint, and I think in that particular issue, that decision was made at the association level, perhaps in the board room of that association. But that was an incorrect response, sir, because at our level, and now with letters going to the System, we have indicated that stockholders as owners are entitled to the articles and the bylaws and the financial reports of their own institutions. And this afternoon, we are meeting with the attorneys general of 11 States who were very concerned with that, including yours, and we will provide them with specific information.

Senator ZORINSKY. Thus, you believe that the denial was an inappropriate response?

Mr. WILKINSON. It was inappropriate, and we concur with you totally, sir.

Senator ZORINSKY. How far have you progressed in your negotiations with other Federal officials concerning a line of credit for the systems from the U.S. Treasury, as reported in the Wall Street Journal yesterday?

Mr. WILKINSON. Yes; we have not at this stage proposed to any administration committee the specific proposal which we have brought to you here this morning.

We have, however, had people who have been working with the work groups under the designation of Secretary Baker of the Treasury, and we have no response back as to what the administration's feeling is on any of that. The information you have here was apparently released by some spokesman for the administration, and that is far more than we have at this time, sir.

Senator ZORINSKY. Do you classify it as a leak?

Mr. WILKINSON. I do not know. I cannot respond to that.

Senator ZORINSKY. Governor Wilkinson, what do you think would be the best thing we could do right now for the Farm Credit System?

Mr. WILKINSON. The best thing, Senator Zorinsky, that you can do right now is to try as the Congress on your own, and, second, to urge the administration to evidence your willingness to in some way provide support to this farmer-owned credit system so that the Wall Street financial community will hear that and it will be more than a rumor in some paper somewhere.

The significant thing that is causing the problems facing farmers today is, No. 1, their debt load and the cost that they have to pay for it. If we can do anything to get that interest rate down through a vote of confidence, that would help greatly.

Second, then, is our own proposal that there be a line of credit.

Senator ZORINSKY. I hear all this conversation about what we should do for the System, but what good, really, will that do for the System if many of your borrowers continue to be in a profit structure where they cannot pay their bills and their debts?

Mr. WILKINSON. Well, one thing that we have stated at various times is if you are really concerned about the basic agricultural sector, then you will recognize the very major adjustment which farmers are being forced to go through at this present time and the impact that has on their collateral values on land. One thing we have urged is that it be drawn out over a longer period of time instead of forcing such a large number of farmers and their lending institutions to take drastic action during 1985 or 1986. This is a transition that is of great significance and needs a longer timeframe in which to function.

Senator ZORINSKY. I have asked other representatives of the Farm Credit System what we should do right now to help the situation. Many of them have answered, "Forget us for the moment, stabilize the economy of agriculture so that land values stop dropping, and then take a look at a way to stabilize the Farm Credit System." I was impressed by the fact that some people in the Farm Credit System actually are worried about the farmer-borrower being able to operate in a healthier economy. This would enable the farmer to pay his debts and would in turn help to stabilize the Farm Credit System.

Mr. WILKINSON. That is exactly right. Your priorities are right; it is just that I do not think you nor I want to see us lose the Farm Credit System's ability to serve the Omaha district and elsewhere. And there is, frankly, a limited timeframe in which that can be done, and that is the 24-month period that I referred to earlier.

Senator ZORINSKY. When we had a hearing in July, your people testified that everything was great. All of a sudden the timeframe changed.

Mr. WILKINSON. That is because the situation continues to worsen so rapidly.

Senator ZORINSKY. Thank you.

Senator HAWKINS. Thank you. Senator Pryor.

Senator PRYOR. Thank you, Madam Chairman. I just have one or two questions.

Governor, I would like to know how many foreclosures are taking place today within the Farm Credit System, specifically those foreclosures not being based upon the arrearage of the farmer involved. In other words, at this point are foreclosures taking place when the farmers are not in arrears?

Mr. WILKINSON. Well, to answer that question, I would see little or no reason why farmers are being foreclosed upon if they are not in arrears, if they have maintained their payments and if the review of their collateral base evidences that they are still in a stable financial situation.

Senator PRYOR. It has come to our attention that foreclosures and foreclosure proceedings are taking place against farmers who are not behind in their payments simply because the collateralized loan has deteriorated to the extent that now under the law that you have the power to force them to come up with this collateral. I need to know if that is true or if that is rumor or is that false.

Mr. WILKINSON. What I would like to suggest, Senator Pryor, is that the System be asked to provide that kind of information to you because what you have inferred, I think we would counter by saying some of those farmers have other sources of income and have the ability to keep their land payments sound.

But we, as the FCA, cannot share with you at this time because we do not have it, how many of those foreclosures under that basis are taking place.

Would it be permissible through us to ask the System to attempt to provide that information to you?

Senator PRYOR. Yes; I think that is a very relevant and pertinent question, and I hope that the answer will come to us fairly rapidly.

Governor, I am not going to make a lot of other statements except just to conclude by saying that I have always had a very, high regard for the Farm Credit System. It has generally worked well over the years and very efficiently. I am very disturbed about the damage to the credibility of the System and the relationship of the Farm Credit System to the Congress as a whole. Speaking only as one Senator, I sort of sense that either you, your people, or this entire System or perhaps those in control have looked at us as not being quite mature enough to realize the depth of this crisis.

In other words, you sort of shielded this information back in July. You withheld it from the committee. It may have been at the request of the administration. But, you know, all of us at this table deal daily with the requirements of farm organizations. We represent farm States. We were not born yesterday. We know the depth of that crisis out there. We have been unable to get a true picture of the depth of the credit crisis. I for one would just like to say that I hope that you will treat us as mature adults. I hope that you will treat us as people who want to help if we can. We may not be able to help as much as you want us to. But right now I think the credibility between the Congress and the System has been damaged a great deal. I am very sorry for that because there has been a very good, strong, and healthy relationship, and that is just what I wanted to say because I am very frustrated about what we heard, the misinformation, the lack of information, what has been stated in the paper, what has been stated by rumor that we pick up on a daily basis. It has been extremely frustrating.

You do not have to comment on that, but I just wanted to make that statement.

Mr. WILKINSON. Senator, I appreciate your statement.

Senator ZORINSKY [presiding]. Senator Boschwitz.

Senator BOSCHWITZ. I believe we have some visitors here, and I might say I also have had a high regard for the Farm Credit System. I think they were founded in the thirties; they had low cost money and they went out and peddled it. Frankly the problems of the Farm Credit System have been caused by very willing borrowers and very willing lenders.

By George, most of the solution has to come from them, though I think, as I outlined at the beginning, we indeed should help. I think the FCA indeed has powers.

Senator ZORINSKY. Thank you.

Senator Heflin.

Senator HEFLIN. Mr. Wilkinson, I have had previous conversations with various parts of the Federal Farm Credit System. For example, we met with some of the officials of the Federal land bank in Jackson.

These officials passed out some material that would indicate that certain types of commodities are produced by farmers experiencing the greatest delinquencies.

Has there been any studies on a nationwide basis as to type of farmers who are in a delinquent state?

Do you have any such information for famers nationwide?

Mr. WILKINSON. I think that a direct reponse would be, as was indicated in a recent USDA report, the basic criteria as to which farmers are facing difficulty today is which ones are carrying a very large debt load. And often these are the ones who were at a certain stage of life during the inflationary days of the seventies and earlier eighties, and expanded their operations.

And today, as the commodity prices in the general agriculture economy does not warrant that type of debt load, they are struggling to remain alive. And they are the ones that find their debt-to-assets ratio at 70 to 100 percent, and have a negative cash-flow situation

Senator HEFLIN. That is not what I am talking about. Do the farmers produce soybeans, wheat, or other commodities?

Mr. WILKINSON. Right. When you go to the commodity lines, you will find that it is the grain farmer, it is the livestock farmer. That is the reason why the upper Midwest, especially the Omaha district, Iowa, Nebraska with a concentration of those commodities are facing. They have lost their markets for grains. And when you talk commodities, they are the ones.

That does not mean that other farmers with other commodities are not in difficulty, but there is a concentration of the problem in those areas.

Senator HEFLIN. Well, the Federal land bank statistics—if I remember the figures correctly, would indicate that 65 percent of their delinquencies were in soybeans. And I believe the next highest percentage was wheat farmers and soybeans and grains.

Mr. WILKINSON. Yes.

Senator HEFLIN. Is this true nationwide?

Mr. WILKINSON. I would say generally it probably is true nationwide, at least 65 percent. The cash grain business. And that includes soybeans, corn, and wheat, yes.

Senator HEFLIN. Senator Andrews asked you the question about the Government program which is getting some type of cash-flow to farmers. And you answered that in effect was that the out-years, that if there were cuts in the target price, could it in effect have an adverse effect upon farmers and their credit problems.

What I will ask you is—not saying with regard to where it comes from—unless the farmer's income is increased, do you anticipate that there is any way a vast majority of farmers who are closer to delinquency can come out of this credit problem?

Mr. WILKINSON. No.

Senator HEFLIN. We have had some testimony before us that it would indicate that you would have to have an increase in farm income in the neighborhood of 10 to 20 percent if the farmer is going to be able to come out of his credit problem. That is the overall average.

Would you agree there has got to be a substantial percentage increase in the profitability to farmers if they would come out of their credit price?

Mr. WILKINSON. Yes; your earlier questions specifically directed its attention to those who are on the stage of insolvency, they are in a very serious situation. And the answer would be "Yes."

There are a group of farmers, Senator Heflin, that are not carrying a debt load. And they are in a survivable situation. But, in answer to your question, yes, there has to be improvement for many farmers in their income situation.

Senator Heflin. Well, some legislative proposals are designed to reduce the price of commodities and reduce the Government support over the next 5 years.

What will be the result of such a policy?

Mr. Wilkinson. I think they have already indicated that when you are concerned with the source of credit, the provider of credit to a particular group of farmers, if that policy reduces the available income to those farmers, it will have a negative effect upon the repayment capacity of those loans.

Senator Hawkins. Senator Grassley.

Senator Grassley. Governor Wilkinson, I think in an exchange you had with Senator Boren, you said a letter was sent out that was inaccurate.

What efforts were made to clarify the misinformation that was in that letter to the membership when that occurred?

Mr. Wilkinson. That response was made by Mr. Edwards. May I ask him to respond to your question, Senator Grassley?

Senator Grassley. OK.

Mr. Edwards. Senator, I sent the chairman of the board of the Wichita bank a letter, telling them they did not have the authority to take those actions, and that further coercion of their associations would result in FCA withdrawing any support they might have for that emergency.

Senator Grassley. Well, the point of my question, and there is nothing wrong with your answer to this point, did the word get out to the individual farmer? If the farmers were told that this was the situation, and it was inaccurate, and if only the people higher up were informed that it was inaccurate, then I don't know whether we have accomplished much unless the word gets down to the grassroots.

Mr. Edwards. I cannot answer that question, Senator. My letter to the bank went out yesterday.

Senator Grassley. I see. (See answer to question 5 on p. 290.)

Well, it would seem to me that you should indicate to the people involved that they need to get out the correct information to all their members the same way the misinformation got out.

Mr. Edwards. Yes, sir.

Senator Grassley. Would you do that then?

Mr. Edwards. We will.

Senator Grassley. Fine.

Governor, during the hearing that I held in September, it became obvious that the System's policies are helping to cause the rapid deterioration that you earlier mentioned.

Why doesn't the System call for an end to the counterproductive policies until we can find a real solution to the problems of the System? In other words, things that are going on, you have admitted have been counterproductive. Would it not be better just to call a halt to it, particularly in light of the fast response and fast interest that the Congress is now giving to this issue, and I would not say that we are giving it timely but at least it is happening. And it was not happening at the time that you and I visited.

Mr. Wilkinson. To a degree, that has already taken place because one of the issues we had to face earlier, and I think we discussed this with you, was that some of the production credit associations in Iowa and Nebraska were at such a stage that they were no longer solvent and that they were on the verge of having to be liquidated.

We made a decision at that time to halt that kind of action, Senator Grassley, and to allow the Credit Bank of Omaha to provide financial assistance to those so that service would be continued through those production credit associations.

Second, and I think the issue you are speaking of, is that in turn drew down the financial strength of the Credit Bank of Omaha to the point where it had to then request of the rest of the Farm Credit System's banks financial assistance to enable it to serve beyond the September date. Part of that assistance package developed by the Farm Credit System was the assurance that before funds would be taken from other districts, the available funds within the Omaha district would be made available to handle its own problems. That was the requirement then of the PCA's and any other of the land bank associations, that any reserves and capital would be centralized for use by the bank. That in turn has caused some of the concern out in the community, especially in Iowa, but that has been part of the financial assistance package of the rest of the Farm Credit System. It is one which we had to rule as being proper because it would not be right to take funds from a farmer of Indiana to assist a farmer of Iowa if the resources had not already been used in that district of Omaha.

Senator **Grassley**. You have mentioned several times that the farmers need to be helped. I do not argue with that. In turn that would help the System. Yet, in the same breath, the practice going on within the Farm Credit System and probably most particularly in Omaha district is to foreclose on individual farmers.

Is this not a contradiction of terms, particularly in light of the fact now Congress is really serious and we all believe that we will be addressing this issue just within a few weeks?

Mr. **Wilkinson**. What has to be recognized is that the institutions we are talking about are private financial institutions. They have to function in a manner that will protect the owners of those institutions.

If a production credit association makes a decision that it will not move against a group, an individual farmer or a group of farmers who are delinquent in their payments, that as a cooperative credit institution increases the cost of the majority of the sound farmers who own that institution. This is the difficulty of any kind of a moratorium or a holdoff concept in moving against those who are delinquent. They have to be concerned about the rest of their stockholders.

Senator **Grassley**. I will not ask any more questions but I would comment to my colleagues that if Congress were not going to act, then I guess I would suggest that maybe the status quo and business as usual would be in order.

But it does look very definitely from all quarters that Congress is going to act.

It seems to me that a few hundred or a few thousand farmers, and most of them are in the Omaha area, could be out of business before Congress acts in just a few weeks. It would seem to me like their condition ought to be judged by the people in Omaha in light of what Congress has done as opposed to the fact that Congress may not do anything. That is the whole purpose of my questioning at this point, is to bring that to the attention of my colleagues, asking for consideration of that point of view later on.

Senator BOSCHWITZ. Madam Chairman, I would like to comment just very briefly on Mr. Wilkinson's last answer, which having been a member of a bank board many years, he says if you do not foreclose, that you have to raise interest rates. If you do foreclose, I do not know what you think happens, Mr. Wilkinson, but you are going to have to write off some debts.

If that does not include raising interest rates to restore capital, I do not know what does. So that certainly you are not going to escape from the necessity of raising interest rates to the healthy borrowers if you are in an unhealthy situation, no matter what you do.

Senator HAWKINS. Senator Harkin. He has been waiting patiently.

Senator HARKIN. Thank you, Madam Chairman.

I have basically three areas that I want to discuss.

First of all, the history of the Farm Credit System. I pointed out one time earlier in the hearing that up until 1971, the Farm Credit System used what was called normal land values on which to base its loans. You could make a loan up to 65 percent of what was then called normal values.

In 1971, that policy was changed, and the Farm Credit System then was allowed to loan on the basis of assets. And I think that is when we got in this whole area of error—not area but error, of kind of a go-go banking by some of the Farm Credit System banks out there. Now it seems that some of the banks are now returning to sort of a cash-flow type of assistance.

Well, I am wondering if perhaps this is not an area we ought to address, that obviously if we are going to be involved in some kind of credit extension or bailout, or whatever you want to call it, we might not want to direct the Farm Credit System in the administration, the regulators, you as the regulator, to return to a system that was used from the inception of the Farm Credit System until 1971 on which to administer its loans. And that is to make it on some kind of an income capitalization value rather than an asset value.

Now, I realize fully that they might not be able to compete with some of the private lending institutions out there. But I do not know that is its responsibility. They have a Federal charter, they are directed by the Federal Government to loan only to agricultural entities. And I am wondering if that might not be the sounder course of action to do in the future.

I wonder if you might comment upon this, getting them to adhere to an income capitalization basis on which to make their loans rather than some ephemeral asset basis.

Mr. WILKINSON. Senator Harkin, you have properly painted the structure of the change since 1971 on through. We have been discussing this. It has been raised in our own Federal board as to whether the time has come to go back to normal land values. One who has been working with that is Deputy Governor Larry Edwards. Would you permit him to respond because he has lived with this as a long-term member of the Farm Credit Administration.

Senator **Harkin**. Sure.

Mr. **Edwards**. Senator, I am not sure I have a very clear answer to your question.

Clearly, in retrospect, lending to buy a plant, which is what a farm is, twice what it will produce in income is not a very good idea. I think I would hate to see statutory restrictions across the board that would prohibit that. Many farmers who have their base farm unit paid for, they may well be able to afford it.

Senator **Harkin**. Fine. Then let them go to a private bank and get it. Let them go out to an insurance company or some place else, but not this special institution which is set up for a specific purpose.

Mr. **Edwards**. I see no reason, Senator, to force a farmer who owns the institution to split his line of credit among several creditors.

Senator **Harkin**. Well, then, do not come to us for a bailout. Do not come to us for money. I mean, you are either a private bank, or you are something else. And if you are a private bank, then do not come here asking for money. Go ahead and let them all go down the tubes. I am sorry to have to respond that way.

But I think again you operate under a Federal charter, it was set up by the Federal Government. I know the bonds have been paid off, but, nonetheless, there is an Administrator, we have set up an Administrator to supposedly regulate the Farm Credit System.

And I am wondering if maybe now might not be the time for Congress to say OK, you have a specific purpose, that is to loan to farmers. You should be conservative in your lending practices. It ought to be based upon income-producing value, and not just upon what assets are.

You can loan up to income producing. If the farmer needed more than that, he can supplement that by going to a private bank and let the private banks take their chance if they want to go above that. Would that be acceptable, to have the Farm Credit System to go ahead and provide that basis up to the income producing. If the farmer needed more, he could supplement that with private, out to independent banks or whatever, insurance companies or whoever.

Mr. **Edwards**. I can only answer the question, Senator, with the way I did before. I see no reason for forcing the farmer to split his financing among several creditors. That is a basic characteristic of farmers who get into financial difficulties, those that are in fact splitting their credit among a lot of creditors.

Senator **Harkin**. So you think the Farm Credit System ought to be allowed to use asset basis or whatever it wants?

Mr. **Edwards**. The Farm Credit ought to have to base its loans on the repayment capacity of borrowers. But for some borrowers who already own their base farm, free of debt, that does not necessarily mean you have to restrict their lending to what the piece of property they are buying will support when they have got an income base that is larger than that.

Senator **Harkin**. Well, I would not say this to the First National Bank of Cedar Rapids if they came in, but they can go out and do whatever they want to. They have got their private shareholders, and if they get in trouble, they have got the FDIC to regulate them and everything. I am talking about the Farm Credit System.

Mr. EDWARDS. I understand.

Senator HARKIN. OK.

Now, I want to make that very clear. I do not know if you have anything to add to that, Governor.

Mr. WILKINSON. No; with this exception, that I think you will remember that at certain times in past years you have not had other lending institutions, especially commercial banks interested in tying up their assets into long-term real estate loans to farmers. That is a reason the Federal land bank is now at 43 percent of that volume.

Senator HARKIN. Madam Chairman, if I could have just a couple more minutes.

Senator HAWKINS. Senator McConnell has been waiting. I do not mind coming back to you, but he has been waiting also.

Senator MCCONNELL. Well, Madam Chairman, to your considerable relief, I am waiting to introduce an outstanding farmer from Kentucky who is going to be in the next panel.

Senator HAWKINS. All right.

Senator MCCONNELL. I am anxious to get to that. I am not going to prolong this. If Mr. Harkin wants a couple of minutes, it is all right with me.

Senator HAWKINS. All right.

Senator Harkin, you may proceed.

Senator HARKIN. Thank you very much. I appreciate that.

Do you have the power to regulate the Federal land banks in terms of their selling land? They have taken—let us say they have foreclosed and they have taken land, and Senator Grassley pointed this out in Iowa, that they are now taking land and selling it at lower interest rates than what they were charging the previous person who owned that land.

Senator GRASSLEY. And they do not have to buy stock.

Senator HARKIN. And they do not have to buy the stock either. So do you have the power to regulate that?

Mr. WILKINSON. The decision of the Farm Credit Administration was that the individual private banks, the land banks themselves, through their own farmer-elected boards, were in the best position to know how prudently to handle that situation in their own locality.

What you do in Iowa is different than what may need to be done in Virginia or California. We have allowed discretionary action there, Senator.

Senator GRASSLEY. You think that is wise policy?

Mr. WILKINSON. Yes; we think it is a wise policy. As we work with the credit problems across the United States, they differ so greatly, and the demand for land is at different stages.

Senator HARKIN. Wait a minute.

Senator Grassley owns a farm. He has his loan at the Federal land bank, he missed a payment, they foreclosed on him. I am a neighbor down the road, I come and I buy that land from the Federal land bank at 2 or 3 percent less, something like that.

Senator GRASSLEY. Nine in southern Minnesota, 10 or 11 in Iowa.

Senator HARKIN. Something like that.

Senator GRASSLEY. And 13½ for me.

Senator HARKIN. So it is about 3 percentage points difference.

Now, if he had had 3-percent cut, he probably could have made it. He could have made those payments, you see. So you have taken the land from him, I have been able to buy it, and I get a cheaper interest rate. I cannot see how you can defend that, and I do not know why you cannot do something to regulate that if it is within your regulatory powers.

Mr. WILKINSON. I think the basic question is should the Farm Credit Administration establish one policy for the United States, or should, because this is a private financial institution, it be allowed discretionary use, and I think your question may very well be one that you could direct to the lending institutions themselves in the next panel, sir.

Senator HARKIN. I just wanted to know if you had the power to regulate something like that.

Mr. WILKINSON. Yes; we would have that power.

Senator HARKIN. And you have decided to wash your hands.

Mr. WILKINSON. And we have decided——

Senator HARKIN. To wash your hands of it?

Mr. WILKINSON. No; we have decided that the farmers in those communities can best be served by the decisions of their own institution.

Senator HARKIN. Not in this one kind of a case. I am sorry, I have got to disagree with you.

Senator HAWKINS. At this moment, we are going to give the court reporter a much deserved 5-minute break and everyone may stand up.

[Short recess.]

Senator HAWKINS. Senator Exon, you have been waiting for awhile. We will go back on the record, and Mr. Wilkinson is back in the witness chair, and Senator Exon, you may have your 7 minutes.

Senator EXON. Madam Chairman, thank you very much.

Governor Wilkinson, first allow me to associate myself with the remarks of many of my other colleagues about our general support for the Farm Credit System which I think is a terribly important ingredient in long-term health of agriculture.

Now to get down to questions. First, let me ask you this question. Is the Farm Credit System prepared, before any kind of a bailout, to commit all of their reserves? In a partial answer to a question a few moments ago, you said that the Omaha system would have to come up with the reserve they lost first, and if that is not enough, then the rest of the System, that may be healthy right now but might not be in the future, would have to come in, as I understand the intent, original intent of the System, to place their reserves up front over and above any taxpayer funds that Congress may or may not see fit to do.

My question is, is the Farm Credit System prepared and have they all committed to do that?

Mr. WILKINSON. The proposal which we brought to you would mandate that that take place down to a reasonable point. You cannot run the banks into insolvency before you come and request a line of credit, which is what we are proposing.

At this stage, Senator Exon, the banks have indicated that they will provide assistance to the other districts. But they at this point have not evidenced that they will fully support on a voluntary basis utilizing all of their available resources before Government funds are used.

Senator EXON. I might say, Governor, that I expect that we may have some difference of opinion on how low those reserves should be.

Mr. WILKINSON. Right.

Senator EXON. And that may be a main contentious point as we move forward.

I am simply saying here that the Farm Credit System obviously borrows from the same window, and I can see where some systems that are relatively healthy today might want to save up, but I reserve our reserves and not the System's reserves.

I think the message should go forth very loud and very clear. The System totally is in trouble because there are some unhealthy particular areas in the System now. And if the System is not going to band together and consider first priorities of the total System, and say, "I am going to protect me," I think we are in trouble.

Let me ask you a question with regards to the Omaha district.

There was recently a story in the Iowa newspapers that indicated the Farm Credit System in Omaha, which is the one in the most serious trouble today, had raised salaries of their chief executive. I wrote a letter to the leadership of the Omaha district asking them if this was true. If it was true, I suggested that the salary increases should be rescinded, given the fact that the Omaha district was busted, and given the fact that we are all going to have sacrifices to work our way out of this.

I also asked that if this were true, for the Omaha system to supply me with the salaries of the top 15 executive officers as of now, and what their history of increases were for the last 2 years. They refused to give me the information that I requested.

Is that a policy of you as Governor, or is that a policy of the Omaha district?

Mr. WILKINSON. That is not the policy of the Farm Credit Administration, Senator. The decision was made by their district board and their management team. Your letter was very appropriate. I cannot respond to you as to why they did not choose to provide you that information.

Senator EXON. As a Governor of the whole System, do you not think that the Omaha people should wake up to the fact that they are pretty bad in their public relations, and would you not advise them that it might be wise for them to come forth with the information that I requested, given the fact that they are coming to the Federal Government for assistance?

Mr. WILKINSON. May I just correct that.

As Governor, I am Governor of the Farm Credit Administration. I do not run or manage the banks of the System. The decision apparently was that of Omaha, but I will agree with you that I think that is information which should have been made available to a Senator.

Senator EXON. Can you get that information for me if I cannot get it from the——

Mr. **Wilkinson**. Yes.

Senator **Exon** [continuing]. District in Omaha?

Mr. **Wilkinson**. Yes, yes, we can.

Senator **Exon**. Will you be good enough to do that?

I appreciate that very much.[1]

One last question, Madam Chairman.

Is it true, Governor, that there is a provision in the farm credit loan that the System itself can call a loan even though it might not be delinquent, if the System determines that it is insecure?

And if this is true, how often is this being used, to your knowledge?

Mr. **Wilkinson**. Would you permit me to ask our examiner, Senator Exon?

Senator **Exon**. Yes.

Mr. **Wilkinson**. Larry Edwards, again.

Mr. **Edwards**. Most mortgages, Senator, would contain such a clause whether they are from the Farm Credit System or anywhere else. I do not know of any case where a mortgage has been called where payments, principal and interest, were current. If you have some cases, I would like to see them.

Senator **Exon**. No; I have no cases. I heard that this was a provision. In other words, what you are telling me is that this and other loans—at least, under your System, there is a clause that says if you have a loan to a farmer, and even though that loan is current, not past due, as of now, you have the option of deeming yourself insecure, if you so choose, and force some type of action on the farmers?

Mr. **Edwards**. I think in those cases, the burden of proof that you were, in fact, insecure is on the institution and not the farmer.

Senator **Exon**. But to your knowledge, you do not know of a single instance where that has happened?

Mr. **Edwards**. No, sir.

Senator **Exon**. Thank you. I thank the Governor, and thank you, Madam Chairman.

Senator **Hawkins**. Senator Melcher.

Senator **Melcher**. Governor, you have outlined in your testimony three alternatives, two of which involve the Congress. These are alternative 2, for a line of credit, and alternative 3, for direct funding by the Federal Government. Is that correct?

Mr. **Wilkinson**. Yes; but you are talking about the alternatives at the end as to what the role of the Government would be. We have zeroed in, if you will note at the very end of the testimony, on the recommendation that there be a line of credit extended.

Senator **Melcher**. Yes; and that is your preferred.

Mr. **Wilkinson**. That is our preferred; yes, sir.

Senator **Melcher**. The administration has told the House that they are not in favor of that. What chances do you think we would have here in Congress to accept alternative 2?

Mr. **Wilkinson**. Was this an announcement this morning, Senator Melcher?

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[1] See p. 289.

Senator MELCHER. The administration has let the House know, however they have done it, that they are not in favor of this. What chance does Congress have?

Mr. WILKINSON. I think Congress would have to evaluate what other alternatives would be available that we could bring to you. One was mentioned earlier, and that is a congressionally mandated guarantee upon the Farm Credit securities, trying to provide confidence to the market. However, the administration would have its say in that one, too, and we have no idea how they would respond.

Senator MELCHER. Have you discussed this with the administration?

Mr. WILKINSON. We have been called into meetings by the Treasury officials, first by Secretary Baker, indicating that they were going to break into their respective work groups and that they were looking at these various proposals. They did not ask us what our recommendation was going to be to you, and I did not have any news as to what the administration——

Senator MELCHER. You have not discussed these recommendations with the administration.

Mr. WILKINSON. No; we were not asked to do so.

Senator MELCHER. Well, might I say, Governor, since they have some amount of influence on Congress, I find it hard to believe that you have not done so thus far, approaching the third quarter—or perhaps we have passed the third quarter, and we are in the fourth quarter. Your testimony clearly states you will get large numbers of failures by customers, and therefore, more loans added to your bad loan portfolio, and you have not discussed it with the administration. I find that hard to believe.

Mr. WILKINSON. No; I think you need to know what was discussed and what was not discussed with the administration. Your question of me was did we discuss a specific proposal as far as a line of credit with the administration. We did not do that, but what we did do, Senator Melcher, was to discuss very freely with them the financial status of the situation, the loss picture. And we have done it with various parties within the administration, in Treasury, Office of Management and Budget, the White House, the Council of Economic Advisers.

Yes; we have been communicating, definitely.

Senator MELCHER. How much time do we have?

How much time do we have in terms of saving, salvaging, what you have got right now?

Mr. WILKINSON. You have 18 to 20-plus months to salvage the System, but that is not the thing that is most important.

Senator MELCHER. It will deteriorate each and every month, will it not?

Mr. WILKINSON. It will continue to deteriorate. And the unfortunate thing, Senator Melcher, as you so well know, is that without some kind of a positive statement from the administration and the Congress, the farmers who own this System and who depend upon the interest rates established by the money market are going to be paying literally millions of dollars extra for the failure of a decision to be made in the Washington community.

Senator MELCHER. Well, as you say correctly in your testimony—I assume it is correct, because it would be my observation that it is certainly correct—the largest number of failures of farm and ranch operators will come in the fourth quarter, and we are already 1 month into it.

Mr. WILKINSON. We are there; yes.

Senator MELCHER. Are you telling us that the $5 billion that you are requesting now might grow if it is not acted upon in this quarter?

Mr. WILKINSON. It could. But we believe that the $5 billion is enough to establish as a line of credit, available for tapping after the System has used its resource base and after it continues to absorb in a businesslike manner the loans.

Senator MELCHER. I understand all of that. Since you do not have administration backing, the evidence is that they are not asking for any prompt action. You have not offered a bill, have you, to the administration to look at?

Mr. WILKINSON. No; not on this specific financial package.

Senator MELCHER. Are you telling us that you want us to act sometime in February, March, or April?

Mr. WILKINSON. No; we are urging that you give attention and act, if at all possible, this fall.

Senator MELCHER. Before Christmas and New Year's?

Mr. WILKINSON. Yes, sir. It is costing in the interest rate——

Senator MELCHER. Yet you have no agreement from the administration that they are going to suggest to Congress some line of action during that time, do you?

Mr. WILKINSON. We had been working closely with them——

Senator MELCHER. Are you disappointed with them?

Mr. WILKINSON. If that is the official word.

Senator HAWKINS. Well, we have a witness from the administration who will be on our third panel, Senator, and we will ask that question of Mr. Naylor.

Senator MELCHER. I can read what they are saying here. And I am aware of what the word is floating around the House of Representatives, based on the administration's position. As the chairman well knows, there is not much that is going to happen here between now and the first of the year, unless there is some plan that has been devised and it has some helping hands. Apparently, the administration does not have any helping hands at this time.

Senator HAWKINS. Senator Boren.

Senator BOREN. Thank you very much.

Just let me ask a couple very quick questions. First, I understand that in the examination, if you classify a loan as a class 4 loan, and that it is then placed in account 215, I believe it is, and you have one that has difficulty cash-flowing. Let us take the example that it is then regarded as a loss by the local association. Let us say a farmer has a $100,000 loan from the PCA, they have cash-flow and collateral, let us say, to service $80,000, that you have to then write off as a loss all of it—you cannot even just write off $20,000 of it, if $80,000 would still cash-flow it. I have been told that there are even examples of cases where you have Federal loan guarantees on some loans that were still class 4 loans, where the full amount has had to have been written off. Is this correct—we have to write off the whole class 4 215 account as a loss in terms of accounting for regulatory purposes? I wonder if there is any flexibility that you have to not count all of that as a loss, particularly if guaranteed. That might help the financial situation in some of the local associations.

Mr. WILKINSON. May I ask Mr. Edwards, please.

Mr. EDWARDS. Our requirements would require that the association charge off that portion of the loan that is deemed uncollectable. So in your example, the charge off would be $20,000.

Senator BOREN. It would be $20,000. If you had any portion of it that was under a Federal guarantee, I assume that none of that portion would be charged off; is that correct?

Mr. EDWARDS. That is correct; yes, sir.

Senator BOREN. And we are receiving some reports that in fact, some people are having to charge off as losses even elements of the loan that are federally guaranteed. That would be a mistake—that would not be the intent of the regulator—if that were happening?

Mr. EDWARDS. That is correct

Senator BOREN. If we were to come back to the $6 billion line of credit—this goes back to what Senator Harkin asked—is there any assurance that you could give us? I feel very strongly that justification for doing so rests upon the special nature of this System. If the nature of the System is to change, then I feel less and less justified in taking that action. Could we be assured that if the $6 billion line of credit is provided, that there would be less pressure or less need to have massive consolidation like the one being talked about now, or just total consolidation, and wipe out all 71 local institutions.

Also, I keep getting letters from people that say, "As my loan gets in worse shape, my interest rate is being raised under this split-interest-rate policy." And I understand you are caught; it is a catch-22. You do not want to run off the sounder people; then you really just leave only the problems as members of the association, and then you are in worse shape than ever.

But on the other hand, it is sad. I have looked into these cases, where if they could have just held their original rates, instead of having their interest rates go up as their loan got into more trouble, they really would have had a chance to make it. But when the interest rate goes up another 2 or 3 points, it just drives them over the edge.

Can you give us any assurance that if this line of credit is forthcoming, that we could see action taken by you, if you have the power to take that action, that would stop or slow this consolidation of locally elected boards and that would allow for some reversal or at least, moderation, of this dual interest rate policy?

Mr. WILKINSON. Our recommendation is the line of credit of $5 billion. And that, frankly, requires the System to utilize as much of its resources as possible. That would not necessarily alleviate a decision on the part of each of the districts as to how best to provide those funds, to make those funds available.

Now, in some districts, as you have witnessed, their choice is to consolidate their associations through stockholder vote into one association, for the purpose of consolidating the capital. There are other districts that have not chosen to go that route. They have agreements, leaving the associations intact, or a modification thereof——

Senator BOREN. That pool their assets.

Mr. WILKINSON [continuing]. But they still pool their assets. That is the critical thing here.

Second, I think we would indicate that the understanding of an available line of credit——

Senator BOREN. Let me just ask you, in terms of your powers as Governor of the System, do you have the power to stop the kind of consolidation that is proposed to go on in the Wichita district, for example? I have no quarrel. I understand the necessity of pooling assets. I understand that. I realize if we do not, we are going to lose some associations, and the stockholders then will lose the value of that stock. So I understand the motivation.

But do you have any power at all in terms of what you authorize or do not authorize in terms of their consolidation plans?

Mr. WILKINSON. Our basic power would be the same as we have had over the years, and that is coercion with the board, or trying to develop a different understanding, or whatever it may be. If, however, they believe firmly in their plan, and if they generate the positive vote of their stockholders, then it is a private decision of that cooperative institution.

Senator BOREN. Well, they believe they have no choice, really. They are not going to be able to have the same rate of interest, and they are not going to be able to still be in existence—or they are going to be liquidated by the Governor if they are on the bounds of insolvency. They really have no choice. I do not know why we bother to spend the money to have elections of the members.

But you really would have no power to stop that?

Mr. WILKINSON. Not to my knowledge—unless my general counsel—no.

Senator BOREN. It has no power at all?

Mr. WILKINSON. The general counsel says the only power we have is to provide full disclosure to those stockholders and let them have all of the facts when they make their vote. But he says no, we do not have the authority.

Senator BOREN. Well, I think that answers the question. You see, one of the problems that some of us have, again, is if we are going to change the whole nature of these institutions, why should we bail it out? And perhaps we should give that power to you to stop things like that in whatever legislation we have, and make sure that that is not happening.

Perhaps we should declare a moratorium on the power of executing this requirement for additional collateralization, a temporary moratorium until we pass permanent legislation. It has been said here that as far as is known, there has been no such case in the System that has foreclosed upon a farmer who is current on his payments; all of a sudden, his collateral has fallen in value by 50 percent, but he is still current on his payments. And it has been said a while ago that there is a legal authority under the regulations, and I presume, written into the mortgages, to give the authority to the lender to demand additional collateral, additional value, if that collateralized value had fallen below the amount of the loan, that if the farmer could not come up with the additional collateral to fully collateralize the value of the loan, you could declare it all due and owing at that time and then foreclose.

I gather from the answer, yes, that is true in terms of the law, that is true in terms of the way the mortgages are written, it is true in terms of the regulations, but that it has not been exercised in any case as far as we know.

Would it in any way hamper the System if we were to declare a moratorium of that particular provision and simply state that for the next so many days, there shall be no requirement made of a farmer who is current on his loan to come up with additional collateral, and no requirement that if he fails to do so the whole loan will be made due and owing all at once?

Mr. WILKINSON. I think the answer would have to be a general one, Senator, and that is that moratoria are not looked upon by many groups as being constructive ways of handling things, even a moratorium of this particular type. I think you have to realize you are dealing again with a private financial institution, and would have to evaluate the impact of that upon that institution.

Senator BOREN. You know, I think that every time you say those words, with all due respect, Governor, you weaken your case, every time you come to us. And I just say, well, fine. Send Chase Manhattan down here to testify before us.

I mean, I really wish you would take out of your vocabulary "private financial institution," because if that is what you want to be, I would just say to the Chair, I think we ought to shut down the hearings and send you home. So I would hope you would quit saying that and take it out of your vocabulary, take it out of your mindset. You cannot have it both ways. If you want to ask for financial help from this Congress, you are going to have to be ready to accept our advice and our suggestions and our legislation on loan policies, what kinds of loans you are going to make to what kinds of forebearance and policy you are going to have on foreclosure, what kind of power you are going to have for locally elected boards. And if it is going to be viewed that that is interference in a private bank, then you ought to go your own private way, without any public money or public credit or public guarantees whatsoever. That is what I think about it.

Mr. WILKINSON. But then you still have to face the reality that the System, because of the mandate of Congress, is a very limited System as far as the ability to diversify its loans, its risks. And I think if you face one reality, you have to face the other, Senator.

I understand your point.

Senator HAWKINS [presiding]. Thank you.

We will excuse you at this time, Governor.

Our next panel consists of Ray Moss Tucker, chairman of Farm Credit Council, who is from Kentucky, and Senator McConnell would like to introduce him to our committee. He is accompanied by James A. Roll, senior vice president, Federal Farm Credit Banks Funding Corp., New York, NY, and Gene L. Swackhamer, president, Farm Credit Banks of Baltimore.

Senator MCCONNELL. Thank you, Madam Chairman.

It is my pleasure at long last to introduce Ray Moss Tucker. Ray Moss is a dairy, tobacco, beef, and corn farmer from Finchville, KY, which is in Shelby County, where my parents live. He began farming in 1956, following a stint in the service. He operates a 600-

acre family farm, which has been in the family for several generations and epitomizes Kentucky agriculture.

He leaves the farming to the next generation of Tuckers while he is here in Washington, serving his fellow farmers.

Ray Moss has been a strong spokesman for agriculture in general and the Farm Credit System in particular. He is a board member and former chairman of the Farm Credit Banks of Louisville, which operate the fourth district of the Farm Credit System. He became the first chairman of the Farm Credit Council, the lobbying arm of the Farm Credit System, in 1982. Today, Ray Moss is here testifying on behalf of the newly formed Legislative Committee to Seek Federal Assistance.

I can think of no farmer in America better qualified to address the problems of the Farm Credit System from the farmers' point of view, and it is with a good deal of personal pride that I present to the committee my friend, Ray Moss.

Senator HAWKINS. Thank you, Senator.

At this time, I would like to ask each of the witnesses to give us a summary, 5 minutes or less, of your statement; submit your written testimony for the record for all members to read, because it is 1 o'clock.

Then, I am going to call Mr. Naylor to join you and we will ask questions of all of you, so we can complete this hearing in a timely manner.

Mr. Tucker.

STATEMENT OF A PANEL INCLUDING: RAY MOSS TUCKER, CHAIRMAN, FARM CREDIT COUNCIL, WASHINGTON, DC; JAMES A. ROLL, SENIOR VICE PRESIDENT, FEDERAL FARM CREDIT BANKS FUNDING CORPORATION, NEW YORK, NY; AND GENE L. SWACKHAMER, PRESIDENT, FARM CREDIT BANKS OF BALTIMORE, BALTIMORE, MD

Mr. TUCKER. Madam Chairman and Senator McConnell, I appreciate the opportunity to be here, and I am sorry you had to wait so long to get around to the conclusion.

Senator MCCONNELL. I am sure it will be worth it.

Mr. TUCKER. As the Senator pointed out, I am from the Louisville district and am director of the district bank of Louisville and also chairman of the Farm Credit Council.

One thing I would like to insert to correct the record, the Farm Credit Council did join with the administration's request to defer the hearings not until the System had determined its position, but to enable the administration time to study our third quarter financial information.

With the limited time that we do have here today, I have with me Jim Roll, vice president of the Funding Corp., who will address that issue, and also Mr. Swackhamer will conclude our presentation by presenting our proposal.

With that limited time, I would just like to say I think it has been discussed—I do have a written statement,[1] as they do, and at this point, I think we have looked at the situation very well, and the problems that we do have have been brought out here. I know we do at this point need the time to present our proposal in full, that needs to be understood.

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[1] See p. 309 for the prepared statement of Mr. Tucker.

With this, Madam Chairman, if it is appropriate, I will turn it over at this point to Mr. Roll for any comments he would make, and then to Mr. Swackhamer. Then we would be glad to answer as a group any questions after we complete the testimony.

Senator HAWKINS. Mr. Roll.

Mr. ROLL. Thank you, Madam Chairman.[1]

I represent the Federal Farm Credit Banks Funding Corp. of New York City, which is wholly owned by the 37 farm credit banks. We are part of the Farm Credit System, and we market the securities of the Farm Credit System on behalf of the 37 farm credit banks.

First, I want to clearly state that we represent to the investing public very clearly that Farm Credit System securities are not an obligation of, nor are they guaranteed by, the U.S. Government. The market for System securities is nevertheless supported by a firmly held belief that because we are Government-sponsored financial institutions, our securities are backed by the Government of the United States.

This is why there continues to be a market today for our bonds, despite our growing financial problems. However, heightened investor concern could mean that we become unable to market securities at all, and thus we would not be able to repay our existing securities when they mature.

As our interest rates rise as they have, we lose our best borrowers. If we lose access to the market, we would soon default on our obligations. That is what we face today, absent Government financial assistance.

During the summer, increased coverage and increased acknowledgment of the agricultural situation began to impact the price of Farm Credit securities. Beginning in July, our funding costs increased about one-quarter of 1 percent. During August, the System released the results of its second quarter operation and said for the first time, based upon what it knew at that time, that we might incur an operating loss for this year.

During the first week of September, the market received the news that plans were being made to seek Federal financial assistance. This news was taken adversely by the market, and raised our costs by another one-half to three-quarters of 1 percent above the U.S. Treasury rate.

Toward the end of September, spreads over Treasury rates stabilized in the three-quarter to 1-percent range, but this stability did not last long. The System's cost of funds increased again in October, another eighth to one-quarter percent, but more importantly, we can no longer sell issues of the size and in the maturities that best fit our funding needs.

Spreads earlier this week were between 1 percent and 1 and one-quarter percent over Treasury. We priced an issue yesterday at 85 basis points—that is, 85/100 of a percent over Treasury—which was down somewhat because of the press report yesterday morning that the administration was considering a credit line for the Farm Credit System.

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[1] See p. 314 for the prepared statement of Mr. Roll.

However, I think one of the most important points in the article this morning was reporting that the administration's move is encouraging, but the market will remain very, very cautious until it sees something concrete from Government. This was quoted as one of the bond traders.

I would like to touch upon one other point, and that is the System's financial reports. We are very, very sensitive to the issue that the System's financial reports are in question, and we have for that reason employed the firm of Price-Waterhouse to do a certified audit of the Farm Credit System for the year ending December 31, 1985. I am confident that the farm credit banks of the Farm Credit System will take whatever actions are necessary to assure that they receive an unqualified opinion from Price-Waterhouse. And this means that they must take these actions and earn this opinion from Price-Waterhouse for the year ended December 31, 1985.

Madam Chairman, continued deterioration in the financial condition of the Farm Credit System without explicit Government assistance will increase the risk that the System will not be able to meet its funding needs at any cost.

This could result in immediate financial crisis in terms of the System's ability to meet its maturing obligations. At the end of the third quarter, the 37 banks had liquidity—that is, cash and liquid securities in the amount of $5.3 billion. This is the cushion of liquid assets that would be used to retire maturing bonds and discount notes in the event we are unable to go to market.

On average, the System must raise over $1.5 billion each week. In other words, absent Government financial assistance or intervention, the System could continue in business for about 18 days if we were unable to market our obligations.

Madam Chairman, thank you, and I would turn it over to Mr. Swackhamer.

Senator Hawkins. Mr. Swackhamer.

Mr. Tucker. Madam Chairman, if I might reemphasize before Mr. Swackhamer gives his testimony that the real reason we are here today—and I just want to reemphasize it—is the profitability in agriculture is what gives us our $13 billion problem that we need to deal with, that we have in nonaccrual loans That is the real problem, the profitability in agriculture. And now, as I turn it over to Mr. Swackhamer to present our proposal, I just wanted that to be part of the record.

Senator Hawkins. All right, fine. Mr Swackhamer.

Mr. Swackhamer. Thank you, Madam Chairman and members of the committee.

My name is Gene Swackhamer. I am president of the Farm Credit Banks of Baltimore. I am appearing before the committee today as a member of the Farm Credit Council Legislative Committee.

Because my colleagues have done such a good job of staying within their 5 minutes, I hope you will let me present a little bit more of my testimony, because it deals with the proposed solution that we offer to this committee.

Senator HAWKINS. You may testify. We may listen.

Mr. SWACKHAMER. Thank you.

I would appreciate that the text of our testimony be incorporated in the record in is entirety.[1]

We are seeking the assistance of Congress and the Federal Government to avert two potential crises of serious proportions for American agriculture and the Nation's economy.

The first is a potential funding crisis. It is critical that investor confidence in the Farm Credit System be restored immediately. The System funds one-third of the Nation's farm debt and one-half of farm real estate debt.

The second is a potential financial crisis as the precipitous decline in farm real estate values and lack of farm business profitability depletes the financial resources of the farm credit banks, associations, and stockholder-borrowers. These conditions further compound the problems of a downward-spiraling farm economy, leading to a crisis of confidence by farmer-borrowers and their cooperatives in this Farm Credit System. The System's deteriorating financial position leads directly to questions of Farm Credit System reliability as a source of credit at reasonable rates.

The ripple effect of Farm Credit System default on farmers, the financial market, and our Nation's economy in general would be devastating. Chase Econometrics is analyzing this issue in some detail for us, and their preliminary findings show an impact more on the order of a tidal wave than a ripple.

A System default would mean that approximately 90,000 farm operators nationwide would have their loans foreclosed in the first year after default. Interest rates paid by farmers are likely to increase 3½ to 4½ percent. And there is a likelihood of a $22 to $39 billion credit shortfall to meet agricultural production expenses.

Because of their holdings of Farm Credit securities, the 3,900 agricultural banks throughout rural America would lose over one-third of their capital. As a whole, the Nation's banking industry would lose close to 10 percent of its capital in the first year and would experience additional losses as other agricultural loans go bad.

Shocks to the economy of the nature being estimated in this study can be prevented with explicit Government guarantees and financial assistance. The first requirement is to stabilize the market for System obligations. This will ensure the continued flow of capital to farmers through the Farm Credit System while it reduces System funding costs and helps prevent significant and devastating increases to farmers' interest rates.

The second problem we must face is how to solve the critical financial problems of farmers and their Farm Credit System. According to USDA data as of January 1985, farmers leveraged greater than 40 percent who also had negative cash-flows in 1984 owed the Farm Credit System $18.7 billion. Those in the most immediate trouble, having a debt-to-asset ratio of greater than 70 percent and negative cash-flow, owed the System $8.6 billion. A total of $3.5 billion in System loans is owed by farmers with debt-to-asset ratios now over 100 percent. The System will incur significant losses which will further deplete the System's capital, regardless of the efforts made to collect these loans.

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[1] See p. 318 for the prepared statement of Mr. Swackhamer.

At year-end 1984, the 37 farm credit banks together with production credit and Federal land bank associations, had total risk funds—capital and loss reserves—of $13.1 billion, with nonaccrual assets amounting to $2.5 billion. By September 30, 1985, risk funds had dropped to $12.8 billion, and nonaccrual assets had jumped to $5.3 billion. By the end of 1985, we project that nonaccrual loans will reach $6 billion. The magnitude of the loss for calendar year 1985 is dependent upon the necessary additions to the allowance for loan losses which will result from loan portfolio studies currently being performed.

In Mr. Roll's statement, he had included the number $13 billion in loans now outstanding that will fall into nonaccrual status in the next 2 years. Even with aggressive management of troubled loans, the level of loans in nonaccrual status is now forecasted to reach $11 billion by December 31, 1987, at which time risk funds of the System are projected to have fallen to $6.9 billion. Of that $6.9 billion, however, $4.9 billion would be farmer-invested stock. In other words, at that point in time, if all the surplus and loss reserves of the 37 banks and nearly 700 associations were combined into one account, the System would have to net $9 billion in recoveries on $11 billion in nonaccrual loans to avoid the impairment of stock.

Madam Chairman, as we considered various options for Government assistance, we have been ever mindful that the almost $11 billion of the $13 billion in nonaccrual loans expected by the end of 1987 will surface from within the Federal land bank portfolios. As the holder of one-half of the U.S. farm real estate debt, we are greatly alarmed by the likely consequences upon farm real estate values, if the land banks have almost 20 percent of their loans in the process of liquidation within the next 2 years.

This underscores the unique role and responsibility of the Farm Credit System in relation to the farm economy. It is on the basis of this special role and responsibility that we call upon Congress to once again join with the Farm Credit System in a program of self-help and Government assistance to help farmers, ranchers, and cooperatives.[1] With this help, we can be a moderating force to the adjustment now taking place in agriculture.

We believe the concept of System self-help embodied in the activities of the Capital Corporation now existing is sound. It is the most efficient vehicle to aid the farmer-owned and directed Farm Credit System. The Capital Corporation is in place, it is operating, and we believe with modest additions to its authorities, it could readily be used to faclitate a program of assistance for troubled institutions of the System

Our proposal specifically would do the following:

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[1] See p. 324 for a news release from the Farm Credit Council concerning the self-help and assistance plan.

It would empower the Farm Credit System Capital Corporation to serve as a financial warehouse through which the System institutions and Government would share in the mounting costs of carrying nonaccrual loans and acquired properties marked to economic value and in other temporary financial assistance essential for the survival of troubled farmer-owned System institutions.

Our proposal would authorize the Capital Corporation to mobilize available System capital through assessments on System institutions, consistent with standards to be established by the Farm Credit Administration. These standards would guard against undue increases in interest rates to farmers in contributing districts, and so that district institutions can plan for their own financial affairs, such assessments could not exceed one-half of 1 percent of interest-accruing assets.

Incorporating moneys available through FCA's present revolving funds authorize the FCA to immediately supplement System financial self-help measures through a provision for loans from the U.S. Treasury of up to $6 billion, not to exceed $2 billion in any fiscal year.

Our proposal would require the System to repay assistance through assessments by the Capital Corporation as System institutions are able to repay consistent with regulatory standards established by the Farm Credit Administration.

Our proposal would require, consistent with conditions of prior Federal assistance to the System, the payment of annual fees equal to the Government's cost of funds, or 25 percent of System earnings, whichever is the lesser, for so long as such loans are outstanding.

Our proposal would maximize local accountability by requiring that as a condition of assistance through the capital corporation, a troubled bank or association shall have first reasonably drawn upon the financial resources of other institutions within its district.

Our proposal would supplement the existing powers of the Capital Corporation to provide it with the operational tools and flexibility necessary to carry out broadened responsibilities; the authority to extend credit and rework loans and to assess banks for System capital assistance.

The proposal would provide for the continued local loan administration, restructuring and management of troubled loans, related assets and acquired property.

Our proposal would cause our regulatory agency to set regulatory guidelines for loan restructuring and property management, taking into account such things as local farm real estate market conditions, production value of real estate collateral, conditions under which foreclosed property may be leased back to qualified borrowers, terms under which System institutions will secure the amount of any deferred principal through participation in future appreciation of collateral or other means. Such guidelines would be implemented in policies of the Capital Corporation and would apply in districts which receive interdistrict or Government assistance.

Finally, our proposal would authorize the Farm Credit Administration to increase legal debt-to-capital limits for production credit associations from the now existing 10 to 1, up to 20 to 1, thus avoiding many otherwise necessary liquidations of troubled PCA's.

In addition, we recognize that as a part of any Federal financial assistance, the public must be assured of the safety and soundness of its investment in the System. As a part of any such assistance, the System will support legislation which will provide enhanced regulatory powers for the Farm Credit Administration, coupled with a withdrawal of the agency from participation in management and operation of the business.

We believe that the enforcement powers of the Farm Credit Administration should be no more nor no less than those exercised by other Federal regulators of financial institutions.

Madam Chairman and members of the committee, if you support and enact this legislation, we believe the following benefits will accrue.

Farmers will benefit as costs of carrying nonaccrual assets are shifted off the books of troubled banks and associations, and the costs of System borrowing are reduced as investor confidence is restored, thus reducing pressure on interest rates.

Enactment of this proposal would assist by permitting farm foreclosures and bankruptcies to be minimized as a direct result of financial assistance that permits more orderly and reasonable workout and restructuring alternatives under FCA regulatory guidelines.

Enactment of this proposal would assist in maintaining farm land values at a more stabilized level as financial assistance in carrying nonearning assets relieves the pressure on troubled institutions to rapidly sell properties in inventory.

And finally, with enactment of this proposal, the Farm Credit System can continue as a viable and dependable provider of credit and related services at reasonable costs.

The obvious impact of no assistance is just the converse of these positions. We would have to continue to operate our businesses on a prudent basis, collecting loans, increasing interest rates to cover losses, aggressively marketing inventoried properties, and pressing forward with widespread consolidation of associations to more efficiently utilize the capital remaining within the Farm Credit System.

The Farm Credit Administration has indicated that without financial assistance, at least 40 production credit associations will be liquidated or forced to consolidate within the next few months, and as many as three Federal intermediate credit banks and two Federal land banks will meet the same fate within a year.

We do not want to see this happen. We do not believe that it is necessary that it must happen, and it is for that reason that we are seeking Federal financial assistance and offering this proposal.

Thank you, Madam Chairman, for your attention and permitting me to make this testimony.

Senator HAWKINS. Could you tell me if the figures you use in your statement are taken from this statement we were given of the 37 farm credit banks, unaudited, combined, condensed financial statement and financial commentary, dated September 30?

Mr. ROLL. Only the statement of actuals are contained in that report, and all figures that we have used in our testimony of actual figures as results come from that statement; yes.

Senator HAWKINS. This committee and other Senators have heard much discussion of the issue of local control. Some say that the consolidations which are occurring are contrary to the System's basic tenet of control by its member borrowers; it has been said that the votes taken by System associations in favor of consolidations were the result of intimidation and other questionable tactics by System officials.

Could you comment on this situation, or are you looking for help?

Mr. TUCKER. Madam Chairman, if I might respond to that, solely on an area in the Louisville district which I am most familiar with. We in the Louisville district are going through that same process of asking our stockholders and fairly, with the best of our ability, with our statements, to present the problems we do have in our production credit associations and some land banks.

We as a board feel it is necessary to try and get this capital where it can be better utilized. We understand we need local control and local direction, and we have agreed as a board that they should continue to have that. It would be somewhat limited in the scope that it now stands, but maybe while we rewrite or restructure, some of this could be given back to those local associations.

But if we do not in the Louisville district vote—and we believe when they fairly understand the picture, that the stockholders will understand the problems– but if we do not consolidate, we face the possibility of liquidating 11 PCA's, beginning immediately after the first of the year in our district.

I do not know whether anyone else would want to comment—Gene?

Mr. SWACKHAMER. Just a general statement, Madam Chairman. I am a strong proponent for local control, and I think most in the Farm Credit System are. It is what has made this System very, very successful through the years.

Local control means the distribution of an operating system where decisions can be made closest to the farmer. That is lending decisions, it is operating decisions, it is counsel and advice. That has worked well, and I think most of us are strong proponents for that. It is where the vote is exercised. It is where loan committees advise management before any foreclosure takes place.

We want to preserve that to the best of our ability. What we are confronted with, after successive years of triggering loss-sharing agreements among associations, is the final depletion of resources that will permit a viable association to remain.

So the alternatives are liquidation or consolidation. And liquidation is a very unsatisfactory solution. So local shareholders faced with that will, I think in almost all cases, vote to consolidate to preserve a lending system.

Senator HAWKINS. Is that not intimidating, though, to give them that choice?

Mr. SWACKHAMER. Oh, I think it is not intimidating to give the shareholder a choice of how to dispose of his assets and his stock. I think it is in the best principle of shareholder rights.

Senator HAWKINS. For the record, could you tell me what assets the System has that might be used to assist those districts needing help?

Mr. ROLL. The System has 37 banks with a net worth of $8.5 billion at the current time as of September 30. In addition to that, the 37 bank system has 1 billion dollars' worth of loan loss reserves.

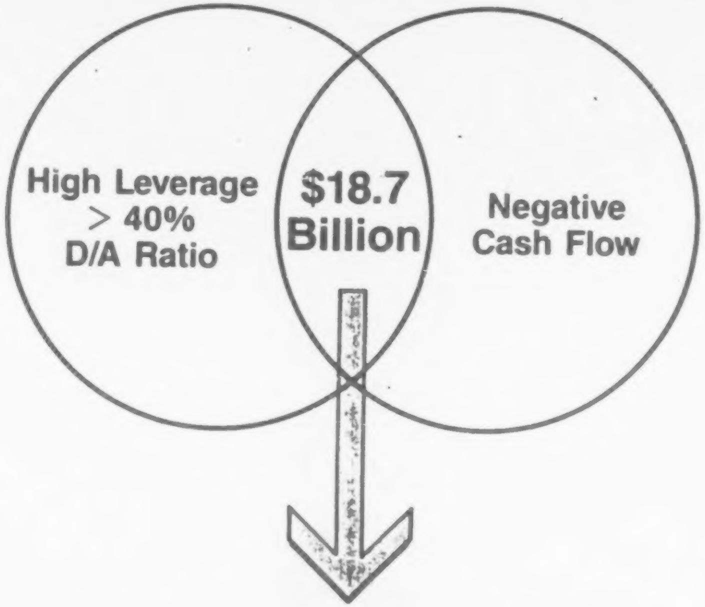
We have a chart, if we could use it, that covers the 37 banks, plus the associations, combined associations, that gives you the total amount of risk funds——

Senator HAWKINS. Do you have a small one for the record?

Mr. SWACKHAMER. We will give a small one that can be included, but we have one here that we think everyone can see, and Mr. Roll can address it.

[The following explanatory charts from the Farm Credit Council were received by the committee:]

FLB/PCA FARM OPERATOR LOANS—HIGH LEVERAGE/NEGATIVE CASH FLOW



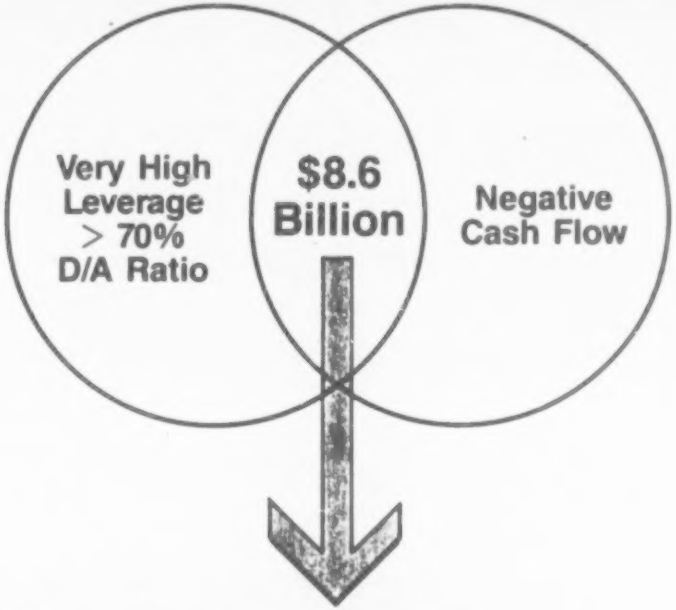
High Leverage
> 40%
D/A Ratio

$18.7
Billion

Negative
Cash Flow

- 26% of FLB/PCA Borrowers
- 45% of Farm Operator Debt Outstanding

FLB/PCA FARM OPERATOR LOANS— HIGH LEVERAGE/NEGATIVE CASH FLOW



Very High Leverage > 70% D/A Ratio

$8.6 Billion

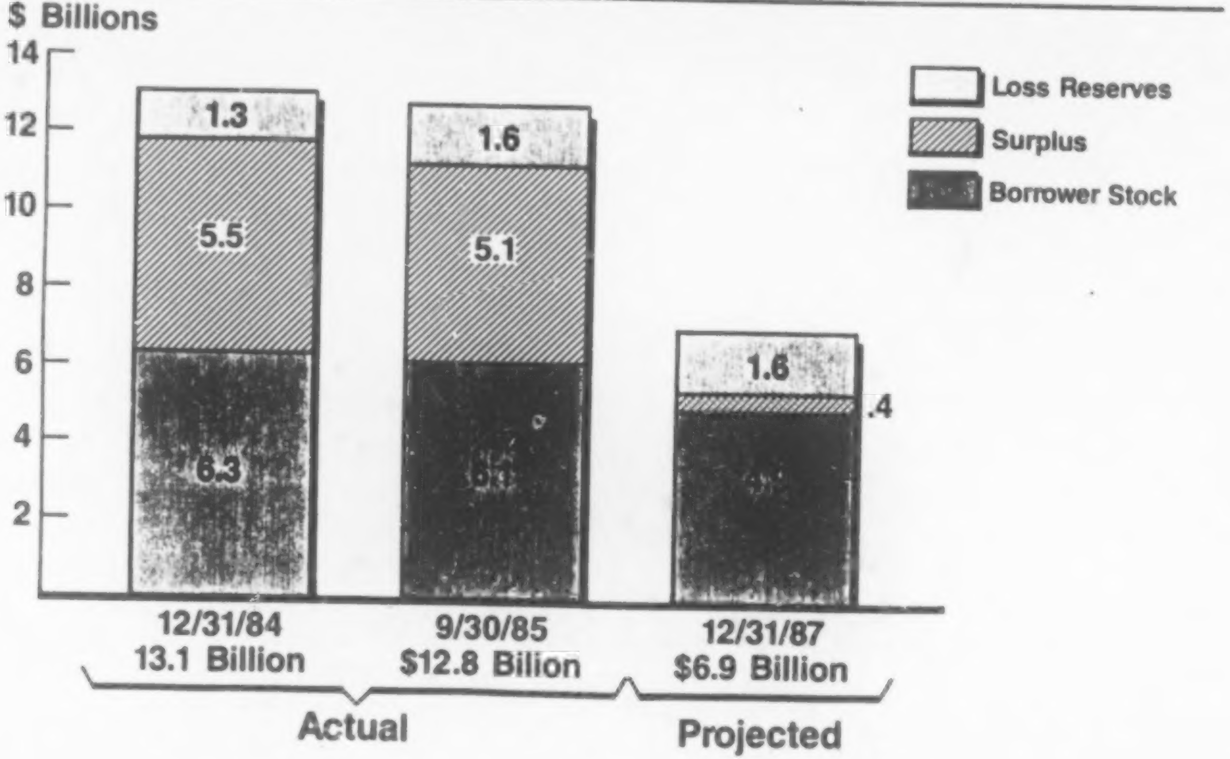
Negative Cash Flow

- 10% of FLB/PCA Borrowers
- 20.5% of Farm Operator Debt Outstanding

FARM CREDIT SYSTEM

TOTAL RISK FUNDS

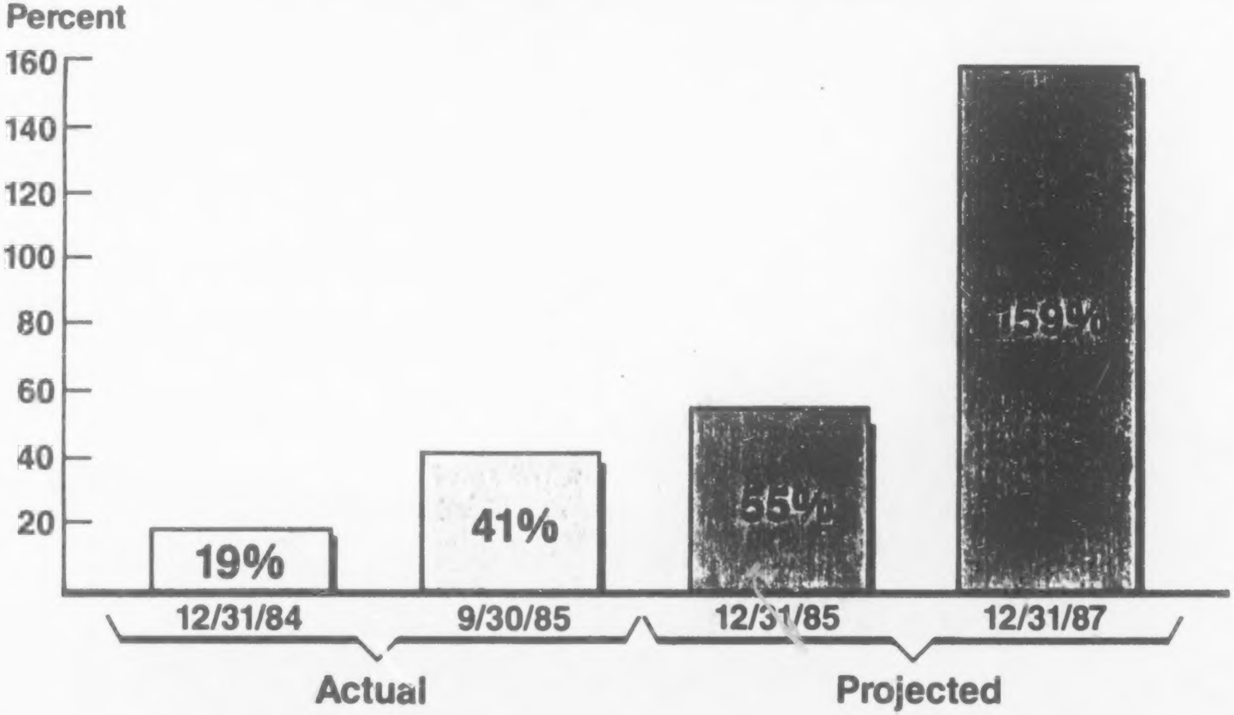
BANKS AND ASSOCIATIONS



FARM CREDIT SYSTEM

NON-EARNING LOAN ASSETS

AS A PERCENTAGE OF TOTAL RISK FUNDS



Mr. ROLL. As of December 31, 1984, we had $13.1 billion of risk funds in the Farm Credit System. This included the banks, associations, the whole System. And $6.3 billion of stock—that is the stock that has been allocated borrower stock. The $5.5 billion is surplus and the $1.3 billion is reserve.

As of September 30, we had $6.1 billion in stock, we had $5.1 billion of reserves, and $1.6 billion of loan loss reserves.

We have projected out that without Government assistance, we would have by December 31, 1987, only $4.9 billion of stock, $400 million of surplus, and $1.6 billion in loan loss reserves.

This shows the impact of taking successive losses throughout 1985, 1986, and 1987.

Senator HAWKINS. What would be the effect, Mr. Roll, on the cost of Farm Credit bonds if Congress were to enact a temporary moratorium on the repayment of all Farm Credit System loans?

Mr. ROLL. It would be a negative impact on the interest rate. The reason would be that the investor would view that as an interference with the functioning of a financial organization which is dependent upon collecting its loans and moving ahead in an orderly manner to pay off its debt.

My view is that the market would view that in a negative sense and would react negatively to that.

Senator HAWKINS. What proportion of the loans being classified as "nonaccrual" under the new accounting system are in fact current?

Mr. SWACKHAMER. The nonaccrual loans are those loans in which there is some doubt as to the collectability of either principal or interest. At the bank level as of September 30 in the financial statement, we showed some 3.5 nonaccrual. Added to that would be the association nonaccruals, which are not included in the consolidated bank statement

The total amount of nonaccrual and acquired property as of September 30 would be somewhere in the range of $5.3 billion, which we are expecting to rise to approximately $6 billion by yearend.

Senator HAWKINS. What share are 90 days past due?

Mr. SWACKHAMER. The vast majority of that recorded as of September 30 were loans that were more than 90 days past due. What we are now in the process of doing——

Senator HAWKINS. Five percent? Ten percent?

Mr. SWACKHAMER. Oh, I would say it is in the 75- to 80-percent range, approximately.

What we are in the process of doing now in the fourth quarter is making a value judgment on each and every loan that is in the nonaccrual status so that we may make proper provision to the reserve for losses by year end to cover those nonaccrual loans.

Senator HAWKINS. Is this the customary practice at yearend, annually?

Mr. SWACKHAMER. It is the practice followed by all financial institutions under generally accepted accounting principles.

Senator HAWKINS. Do you operate under those rules?

Mr. SWACKHAMER. We are operating under those provisions. That is a requirement if we want to realize an unaudited financial statement from Price-Waterhouse at yearend.

Up until this time——

Senator HAWKINS. Was the last financial report to investors certified by an independent auditor?

Mr. SWACKHAMER. I will ask Mr. Roll to respond to that. It is his responsibility in the funding corporation to put that together, and he can better explain its production.

Mr. ROLL. In the past, we have produced the report to investors utilizing a certification of the Farm Credit Administration as examiner for the System. We have not had them certified by an independent public accounting firm until this year, which we will have a certification of an independent public accounting firm this year.

Senator HAWKINS. Is the Baltimore banks' independent account certified by an independent auditor?

Mr. SWACKHAMER. As president of the Farm Credit Banks of Baltimore, I can say to you that we started the first certified public accounting in our banks over the objection of a regulatory agency, but nevertheless believing it to be prudent, and that was then expanded to the Farm Credit System in its entirety.

Senator HAWKINS. So is the answer "Yes"?

Mr. SWACKHAMER. The answer is "Yes."

Senator HAWKINS. And how long have you done that?

Mr. SWACKHAMER. We will be in our second year.

Senator BOREN. Why did they object—on what basis?

Mr. SWACKHAMER. Well, it was not in conformance with the regulations which proscribe the Farm Credit Administration to examine and audit the institutions, and I think their feeling was it was a duplication or a redundant activity.

Senator HAWKINS. And how long have the banks been in existence—you have been doing this 2 years?

Mr. SWACKHAMER. Yes.

Senator HAWKINS. And how long have you been——

Mr. SWACKHAMER. The Farm Credit System was created 2 years following the creation of the Federal Reserve, so it began with the land bank in 1916.

Senator HAWKINS. Senator Boren.

Senator BOREN. Are any of you familiar with the study report sometimes called the "Project 1995"?

Mr. TUCKER. Yes, sir.

Senator BOREN. How did that come about? How was that commissioned, or who undertook that study?

Mr. TUCKER. I will ask Mr. Swackhamer to respond to that.

Mr. SWACKHAMER. Well, the Project 1995 was a strategic planning effort made by the Farm Credit System which commenced about 3 years ago, for the purpose of providing better direction to us for planning in future years.

It was a long and involved study, involving all the districts, many borrowing organizations, a lot of outside experts, and produced a strategic plan for consideration by the Farm Credit System.

Senator BOREN. I am just quoting from some parts of it, which give us the drift of it. It says:

> In the future the system will have to choose between narrowing advantages of its relationship with government for growth opportunities, broader markets, and a more free enterprise market-oriented pattern.

And in some other parts, they talk about it becoming a full-service financial institution.

> Business Principles. Virtually every finding of the project points to the need for the system to revise its business principles. The system can no longer afford the luxury of the slow, methodical decisionmaking process that involves grassroots input.

It says:

> We believe it must move to a more profit-oriented market approach.

Then it talks about hurdles to overcome in winning support for Congress.

> Competing providers of financial services to rural America will seriously challenge the expansion of the system's mission to permit further intrusion into "their turf." Success in winning Congress' approval of an expanded mission will depend upon authorities being sought and the constituency to be served. Traditional owner-borrowers.

I presume that means family farmers—

> Will likely oppose any change which would weaken their control over the system.

That is certainly true.

> The prospect of such opposition of the traditional farm groups suggests the system should first expand its customer base to include a larger, agriculturally-related base before opening eligibility to include a broader segment of rural America.

In other words, it really sets out a blueprint for moving in the direction of a privatization of the System away from the traditional customers that are served, away from the traditional elements of grassroots control. And it even talks about, almost paraphrases, my opening statement that we have to be sure we are not here providing a special bailout, if what you want to be is a private bank, to go out and compete with other private banks. You do not want to do any more, apparently, from what has been said.

Has this been officially accepted or rejected by the Farm Credit System?

Mr. ROLL. It is my understanding the report was prepared for the consideration of the districts and the other entities. It is available research information in its earlier phases.

Senator BOREN. So it has not been rejected.

Mr. ROLL. It has not been accepted or rejected.

Senator BOREN. It has not been accepted or rejected. I would just comment that as one member of the committee, before I vote on any kind of action on what we should do, whether we should accept this $5 billion line of credit proposal or not, that I think we should have some very clear understanding from the Farm Credit System about attitudes toward the philosophy of this kind of document, which is in total opposition to everything that the System has been in the past.

I would think that until it is clearly and totally rejected and until commitments are made, you should stop some of this consolidation that is going on of local boards. I am not talking about pooling of assets, and so attempt to target resources, a drawdown of surpluses by district until we can pool and utilize all of these resources. As I look at the administration, they are suggesting that we do that before we continue to increase the interest rates on these family farmers. There are going to be problems.

Let me clarify one other point. We have heard from Governor Wilkinson about this range of salaries that has been changed and the huge increase. And I had the figures on our district of operating costs, gigantic rates of increase in most of the banks in the System over the past 5 years. Then we had this change of salary range which I quoted earlier and which Senator Exon referred to. He said Omaha had been unable to even give him the salary ranges of their top 15 employees The change in this range from $66,000 to $120,000 in 1980, permissible range set by the board of governors, was to the range of $146,000 to $233,000. They said, "Oh, that is just a range." I have been told by some in the Farm Credit System that they did not really want to do that and get all those big raises when the farmers were in such trouble, but that the Governor, Governor Wilkinson, and his cohorts, imposed them on the local districts. I heard the implication being from him that they felt obligated to set some sort of range. I suppose the implication was that the pressure was coming from some place else.

Who was it that asked for this, and does the local bank have no authority to refuse to operate in those ranges when all their customers and their so-called owners are all going broke. We have to put the owners in quotes because they are taking all the powers away from the owners at the grassroots.

Who was it that did that? Can we find out? Who changed this range and who wanted it changed?

Mr. TUCKER. Senator Boren, if I might refer to that, and I can only speak from the local district. One of the things, as I see it, that has brought about this change is that we had individual banks up until a certain point, and then when the banks were combined with more responsibility, where the President's net range could have possibly increased would be one answer.

I can only speak as a farmer and as a president of a large Southeastern dairy co-op and also as a director of the farm credit banks in Louisville. Salaries are important. They are important to the people that do the work or do the work for us, and they are also important to the people that pay that bill. I can understand that. But one of the things we have to look at, we have to be competitive in the open market, even if we only lend to one segment of the industry, to get those good people.

I would hope that as we see—and I know we are having problems now keeping some of our good people down at—especially down in the lower ranges and the loan officers because of their uncertainty in the Farm Credit System. We have had a lot of experience, especially in the district, of getting those good people, training them well, and then they leave for much larger salaries in the private sector.

Senator BOREN. There might even be a few Senators available at $233,000 a year. But I still do not think I understand. Did the pressure come from the Governor? Did he impose this change of range of salaries, or did the pressure come from the local, regional district boards? Who wants to step up and assume responsibility? Since we are asking for $5 billion, I do not think any of us wants to write a blank check without some degree of accountability back to the taxpayers who are going to guarantee this line of credit and might be drawing on it. They will want to know who it was. Who is in charge here?

Mr. **Tucker**. I cannot speak for the Farm Credit Administration. I can speak only for the board that I serve as the director on, and we as a board have always set those salaries with our board. And, of course, at that point we had to get FCA approval. But we did as a board set those salaries.

Senator **Boren**. The administration apparently has recommended that we abolish the current board of governors of the Farm Credit System as it is now, FCA, and that we replace it with an independent authority, restructuring the present management board with a single chairman appointed by the President and confirmed by the Senate; that we set up at agency status a totally separate, independent auditing, regulating body. What would be your reaction to that?

Mr. **Tucker**. Senator Boren, we do realize that we do need an independent regulator in the System more so than we have had in the past. We as the System need to make our management decisions, our operating decision and those decisions, and the FCA needs to be strictly an arm's-length regulator.

That is our belief and I would ask either Mr. Swackhamer or Mr. Roll if they would want to comment further on this point.

Mr. **Swackhamer**. Senator Boren, I testified before Senator Zorinsky earlier on his FCA powers bill, and we stand ready as a regulated system always using somebody else's money that we buy to accept tough regulation. We have never opposed that, and we are more than willing to work with Senator Paula Hawkins and her subcommittee in drafting such legislation.

Senator **Boren**. Basically you are favorable to the administration proposal.

Mr. **Swackhamer**. We support six points of the FCA intermediate powers bill, and we have disagreement with about six. We support the intermediate enforcement powers similar to other regulators. We support their regulation of the preparation and dissemination of information to stockholders and investors.

We believe they should delete the prior approvals that places them in the operating aspects of the bank's business as they have suggested. We agree with the change to section 519 providing for certain delegations. We agree with changed examination authority. We agree that FCA should not be the operation point for handling financial transactions of the Farm Credit System.

We disagree with several other positions. They are technical.

Senator **Boren**. What is the main disagreement?

Mr. **Swackhamer**. The disagreement is mostly in terms of the words that they use. We do not agree granting a regulatory agency the power to conscript capital and to usurp local control on its use.

Senator **Boren**. When you say "conscript capital," what do you mean?

Mr. **Swackhamer**. That means take it from one corporation and give it to another by forcing the merger.

Senator **Boren**. Is that not what you are doing right now?

Mr. **Swackhamer**. There is a big difference.

Senator **Boren**. Are you not taking it from the so-and-so PCA or the so-and-so land bank and pooling it with another?

Mr. **Swackhamer**. There is a big difference between a group of farmers who own their organizations voluntarily agreeing to do that and a Government regulatory agency forcing a weak financial institution to merge with a strong one over the objection of the board and the shareholders. There is no other regulatory agency that has that power.

Senator **Boren**. There are no mergers of local associations occurring now?

Mr. **Swackhamer**. Not as would be forced under this provision without the consent of the board or the shareholders, and we object to that provision.

Senator **Boren**. You cannot pool capital now?

Mr. **Swackhamer**. We can do all of those things with the consent of our boards and shareholders now. We object to giving to a Government agency the power to force the merger of a strong and a weak organization over the objection of its own board of directors and its own shareholders.

Senator **Boren**. Well, I guess I have a hard time understanding that, when that is exactly what I see the Wichita board, for example, proposing to do in our district. How is it somehow good policy to force Anadarko, Altus, and Woodward, OK, to pool with Muskogee, OK, but it is sometimes, somehow horribly evil to force Omaha to pool with Wichita to pool with Louisville.

Mr. **Swackhamer**. Well, I think there is a subtle but important difference, and that difference is the voluntary action of the banks and associations versus Government action to command that.

Senator **Boren**. You really think all that is voluntary that is going on? I had a hearing, for example, in Oklahoma. We had people from all the local PCA's and land banks, about 250 people from all around the State, pretty diverse geographically, and I asked them, I said how many of you are in favor of this? Only one hand went up, a member of the Wichita board. Every other hand went up, 249, opposed.

I can tell you when they think they are going to lose all the value of their stock, or they are going to lose the right to borrow at the window at the same rates of interest, or they are going to have loans transferred, I would be shocked and surprised if any of them have the courage to risk it. Very few of them can afford to put at risk the value of their stock to defy the orders to consolidate.

I do not see how that differs as a practical matter from what you are opposing at the national level.

Mr. **Swackhamer**. That is why our proposal for Federal financial assistance is so important because it helps relieve the pressure on the banks and associations from having to take such actions when they face insolvency.

Senator **Boren**. Would you be willing, then, since we are talking about $5 billion, would you be willing to support our efforts to declare a moratorium on any other local consolidation for, let us say, a 4- or 5-month period until we can determine what we are going to do about this $5 billion request? Would you be willing, as a System, to support that kind of moratorium?

Mr. **Tucker**. Senator Boren, the longer we wait on the request that we present 4 or 5 months down the road, the problem only gets deeper and the hole gets deeper.

Senator BOREN. I am not asking you to wait to submit it, but would you be in agreement with requesting and getting all of the member districts of the Farm Credit System to wait for a few weeks until Congress has had a chance to act on this proposal before they proceed with any votes for further consolidation?

Mr. TUCKER. Certainly, we would be sure to work with this committee in ways that we can, but again we come back to the very important fact that the financial assistance is very urgently needed and we need to move as quickly as we possibly can.

Senator BOREN. Before we ask the taxpayers to guarantee the System, what is wrong with the administration's proposal to establish, I think they call it the Farm Credit System Corporation, and draw down the amount of surplus fully? On your charts you showed what would happen without Federal assistance, that there would be a drawdown. What is wrong with having the association to pool its resources, the System to pool its resources in that manner and draw it down before we ask the Government to step in?

Mr. SWACKHAMER. The statement I think you are referring to is probably the one presented this morning, and it will be, I suspect, presented here later by the administration. I think the first two or three paragraphs of the statement are very important. It does indicate that the Farm Credit System is continuing negotiation with the administration. We believe that they have acknowledged that there is a very serious problem, both in the agricultural sector and in the financial markets.

They have agreed with our numbers. In fact, they even believe that we might be understating the magnitude of the problem. We have not yet succeeded in convincing them that we have an immediate need, and that is still in process.

I will tell you what is wrong with their policy: It requires that we consume all of our capital surplus, lost reserves, and stock. It requires that we merge associations. It requires that we raise interest rates. It requires that we accelerate foreclosure, and it requires that we must aggressively market our acquired property or we fail. I would call it a scorched Earth policy and a return to a financial dust bowl. It is inadequate. Further, we do not agree with the Farm Credit Administration's proposal for a $5 billion contingency line. That, too, is inadequate.

In our testimony we are suggesting that we need the cost of carry for some $10 billion of nonaccrual assets, and that is a fiscally responsible position that we can defend.

Senator BOREN. Well, Madam Chairman, I see Mr. Naylor is here, and I know he is going to want to comment on this. But again let me just repeat what I said before. Before I am going to be prepared to vote for anything like this, I want to see a list of what the System is ready to do. Just exactly what is going to happen to the salary range, what are we doing to get the operating costs down, what are we doing to stop the continued consolidation and loss of local control, what are we going to do in order to set up an interest rate policy that will not make it even harder on those family farmers that are already having trouble? I think that a number of us would be very willing to pay for desirable social and economic objectives. But until we know where the money that we are providing is going to be used in financing those desirable social and economic objectives, we are simply going to be unwilling to do it.

I would say that the best proposal you could make would have been to have come forward with some admission of guilt for past mismanagement and moving in the wrong direction along the lines of apologizing for not throwing this so-called strategy statement in the wastebasket and burning it the first day. I think any elected board member should have been as incensed at this kind of thing as I was incensed by it the first day I was presented with it.

To even have it still under consideration is an indictment of the attitude that is prevailing in the System. And until that attitude is cleaned up and until you decide what you want to be, it seems to me that there is a split personality here.

You have a dual personality and you have to decide. Once you decide, come back and see us. If you want to be a public institution that serves the public purposes, come back and see us. If you want to be a private bank, good luck.

Senator HAWKINS. Thank you, Senator Boren.

Let me ask just two more questions. I know Secretary Naylor is waiting here. Let me just put for the record for the other Senators to read, it is my understanding that the district banks examine the local associations and the PCA's both; is that true? The district banks examine the local associations and the PCA's?

Mr. SWACKHAMER. We perform a credit review of the Federal land bank associations and the production credit associations.

Senator HAWKINS. Are not the local associations and the PCA's the theoretical owners of the district bank?

Mr. SWACKHAMER. The stockholders who borrow from the System are the owners. Each borrower under law is required to purchase stock and those who hold the stock are the owners of all the institutions in the Farm Credit System.

Senator HAWKINS. And the land bank associations buy the stock in the district Federal land bank.

Mr. SWACKHAMER. That is generally correct in the land bank association case. In the PCA and credit bank case, there is also a banking relationship in that we provide funds to the PCA, which is the primary lender.

Senator HAWKINS. Thank you very much. I will excuse you and ask Frank Naylor, the Farmer's Home Administrator to come before us now.

Mr. TUCKER. Madam Chairman, we thank you very much for the opportunity to appear before you and we stand ready to work with your committee.

Senator HAWKINS. Thank you. We look forward to making some reforms here.

Frank Naylor is the Under Secretary for Small Community and Rural Development. We look foward to you giving a 5-minute summary of your statement, which I am sure we have all had reports on.

STATEMENT OF HON. FRANK W. NAYLOR, UNDER SECRETARY FOR SMALL COMMUNITY AND RURAL DEVELOPMENT, U.S. DEPARTMENT OF AGRICULTURE

Mr. NAYLOR. Thank you, Madam Chairman. If I may, let me just briefly summarize some of our views as we continue an intensive administrationwide review of the strengths and weaknesses of the operating part of the Farm Credit System.[1]

We anticipate that indeed the System will be required to report very substantial losses or more correctly, potential losses, during the remainder of 1985, 1986, and 1987. Using their figures, approximately $6 billion of total potential loan losses may occur based on the macroeconomic assumptions of the Department of Agriculture's general ag economy model.

The other side of that coin, however, is that the Farm Credit System is and remains one of the strongest financial institutions in the country. They have a very strong balance sheet. I think you saw earlier, Madam Chairman, their very substantial resources totaling some $12.8 billion of earned surplus, lost reserves, and other resources in the form of borrower stock.

One of the major problems the System has had is the difficulty in mobilizing that capital to deal with loan loss problems because of the System's highly decentralized character.

They have also had considerable uncertainty as to the extent of FCS losses in the marketplace. The market was questioning whether or not they had the ability to deploy those resources to use them effectively. As a result, they have indeed been paying a premium in the last 60 days for the sale of their securities.

Finally, the System has experienced a considerable problem because the Farm Credit Administration has lacked the authority and the enforcement powers to provide the types of arm's-length, independent supervisory judgments that is appropriate to this style and size of financial institution. The effect of this compound situation has been rather dramatic.

It has placed increased pressure on farmer's stock, particularly in the districts that are under the most severe difficulty. It has resulted in increased interest rates, and it has resulted in the stock being at risk. It has forced them to undergo restructuring of loans without the benefit of the cushion of the cooperative's collective strength rather than just a particular institution.

I think we need to make it clear that the administration recognizes the very vital role, Madam Chairman, that the Farm Credit System plays and the importance that it has to America's farmers.

We want that System to continue as a viable lender and supplier of credit, and we want it to retain its cooperative nature with local management of its lending association. We have, in looking at the need for reform, essentially used three criteria in making the judgment on what perhaps should be addressed and pursued in this area. First, we want the System to continue to be able to supply credit at competitive rates of interest to producers in their marketing area.

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[1] See p. 328 for a summary of the administration's position on the Farm Credit System.

Second, we want them to be able to have appropriate access to their resources so that they can undertake reasonable loan management procedures, including restructuring, leasing, and other steps, to help farmers that are under stress and do that in a balanced and prudent fashion.

And, finally, we want the actions that might be taken or proposed to protect and safeguard the borrower's investment within the System. We do not want to jeopardize that.

The recommendations of the administration deal with each of those issues. They deal with them in the sense that, first, we feel there is a need for creating the authority internally to pool resources to effectively manage loans that are problems, and to handle them in a way that is responsible and reasonable in dealing with borrowers.

Second, we feel that the Farm Credit Administration needs a significant reform, an arm's-length arrangement in which it can provide the proper type of supervisory directive for the System.

We recognize that there has been a good deal of discussion today about whether or not there should be additional Federal involvement. Madam Chairman, the administration is continuing to assess this very serious problem, but it is our feeling that we need to work very closely with the Congress and your subcommittee and your counterpart in the House of Representatives, to develop and bring to some conclusion the general thrust of the first two steps, so that we know the base from which we are working.

If we can come to some agreement and the Congress is willing to legislate these first two steps, as I think we have had indication there is interest in doing, the administration will assess the need for Federal financial assistance and make that evaluation.

I think it is important that we put into perspective the System's own considerable strength. Using the System's own numbers and reasonable projections into the next several years, they will, by setting aside the necessary funds for lost reserves and dealing with the losses that they expect to occur, would indeed reduce their earned surplus to a level in 1987 of approximately $700 million, and they would not impinge in any fashion on their members' stock, which is roughly some $5.5 billion.

During that same period they maintain a very strong capital as a percent of assets ratio, never going much below the 8-percent range. Then it is our view, Madam Chairman, beginning in 1988, if the System follows prudent steps, they will return to profitability.

The issue here really revolves around Federal assistance, and whether or not the System can maintain access to the marketplace, which is critical to its ability to sell securities at competitive rates; and what kind of assurances are necessary in the marketplace to ensure that that indeed does occur.

As long as the System has access and has those competitive rates, then it is within their current capacity to be able to manage the problems they have with their considerable resources. There is always the margin of error. There is always the question of whether or not that is adequate. But I believe, as we have indicated here, that until we have a better picture of the first two actions and the discretions and the powers that are involved, it is extremely difficult for us to assess the extent of financial assistance that may be necessary to give that assurance to the marketplace.

We want to work very closely with your subcommittee to develop, as we are doing now, the basic tenets that would be involved in that general base of legislation so that we can get that concluded.

It is our view that, for the System's health and for the American farmer, it is desirable to come to an appropriate solution to this problem yet this calendar year. It is a complex issue. It is not one that will be readily resolved, but we stand ready to work on a bipartisan basis with the committee and with the System, and will continue to talk and to work this problem out. We think it can be accomplished.

Senator HAWKINS. Thank you.

Senator BOREN. Madam Chairman, do you think Mr. Naylor might respond to the comments made by the last panel that they believe that if this plan were to go into effect: One, that it would do violence to force a pool, do violence to the concept of local control more than the current system does; two, that it would increase interest rates substantially, exacerbating this problem we are trying to deal with which we talked about before you came in. They are in a catch-22. They do not want to lose their good customers. So they are giving them preferential interest rates. On the other hand, that means they have to raise the interest rates for those that are in bad shape. I do not know how many people have written to me and said, "If I just had three or four points lower interest, which is where I started when I first started a loan with the System, I could make it this year, but with the rates I am being charged, I cannot."

So it is a vicious cycle, but they seem to think this will cause an escalation of it. I wonder if you might respond to those comments. I think you heard those comments made.

Senator HAWKINS. Were you in the room?

Mr. NAYLOR. Yes, I was.

Senator HAWKINS. I was thinking the same thing. Could you respond to their fears?

Mr. NAYLOR. Frankly, Senator, we do not share those views. The Treasury Department and ourselves have reviewed the situation extensively and I think very carefully. And I would go back to our objectives. Our objectives were to maintain competitive rates at the association level. That can be done by pooling loans in the capital corporation and the proper managing and the pooling of assets. The process that we are talking about also depends on the adequate assurance to the market of prudent management, prudent supervision, and assurance that the System can effectively use its assets to deal with problem loans equitably and use prudent management in the handling of those loans. In fact, if you look at the System's own assumptions, at the end of 1987 out of the $13 billion in problem loans which they anticipate may develop over that period of time, $11 billion of them will still be carried on their books.

This does not indicate in our mind a precipitous policy of liquidation or excessively tough treatment of individual borrowers, but indeed indicates the capacity for a reasonable degree of flexibility in restructuring and leasing back and taking other actions that may be prudent and appropriate.

And, finally, we have very carefully indicated that at no point—and this reassurance I think is important to their current customers and prospective customers—at no point would we anticipate that it would be necessary to move into the stock bought by the individual borrowers in the course of their borrowing from the System.

Senator **Boren**. Let me ask you this question: I do not mean to intervene, but it is a concern you and I both have; how could we be sure? Now, under the current system, if they chose not to pool—let us take a local PCA or a local land bank—they can use their own discretion without entering into a pooling arrangement. Under your system this kind of pooling would bring it all the way down, not just districtwide but down to the local level.

If they chose in their discretion not to pool with a local association but to liquidate, which could be done now? The local association obviously can be liquidated, and when the value of that stock is lost, I assume that what they are saying on their charts is that the reserves do not shrink. They stay the same, $1.6 billion. The surplus is all right. They project what will happen without Federal assistance. But the stock shrinks considerably, $6.3 billion down to $4.9 billion, the loss of the value of the stocks.

I assume they would assume a situation where the discretion would be exercised, the value of the stock would be lost through liquidation of local associations, I presume.

Mr. **Naylor**. We have not perceived that this would be necessary. Certainly, if they have the necessary authorities for pooling and efficient use of their reserves, that type of thing can be managed. Indeed, the effect of lack of pooling is evident in some of the most distressed districts now, when they very quickly reach a point in a local association where they have no choice but to raise interest rates, impair stock, or to engage in very strong liquidation policies and the strength of the entire System's reserves behind them, that, by and large, could be avoided and a much broader discretion is available to them.

Senator **Boren**. Well, let me ask you this about your plan.

Senator **Hawkins**. Just one moment. Am I hearing it right? This would go for the System to draw down the bank reserves before they go after the owner's equity, not that they have to go after the owner's equity, but if there is one-two, that is the way it would be.

Mr. **Naylor**. Our presumption, Madame Chairman, is that the earned surplus would be the first and the reserved losses would be first.

Senator **Boren**. For the value of the stock.

Senator **Hawkins**. Before the value of the stock.

Mr. **Naylor**. And at no time under their own assumptions on projected losses would you exhaust those funds.

Senator **Boren**. Let me ask that because I think that is so important. The chairman and I have talked about this, and she is very concerned about it, too.

I would hope that in thinking about your proposal that there would be two or three things that you could build into it to assure it. I am afraid if you leave a broad range of discretion, that there could be cases where they would not use the pooling effectively to prevent the loss of value of the stock when you are liquidating certain local associations, maybe even in some districts having massive liquidations and loss of stock value on a districtwide basis.

I would hope that whatever proposal finally comes out the administration would take three things into consideration: No. 1, requiring other actions be taken first before any stock is impaired, any local association or district, which is, I gather, the policy guideline. That is the objective. But I am saying that I would hope you would batten down that objective that you have just given, nail it down in a manner in which the discretion is not left, the way the pooling is handled, to impair the stock.

Second, I hope that you would batten down this question of interest rates. In other words, that if there is an option of pooling to a larger degree in order to avoid escalation of interest rates, that that pooling and the drawing of the surplus would have to occur before they again turned toward raising interest rates, especially for those family borrowers who are in trouble.

And, third, I would hope you would consider, at least in the organizational structure—I am not talking about any provision of pooling of assets or resources—but in terms of maintaining the identity as an organization or local associations and locally elected boards, that there would be some provision that would slow this massive consolidation process.

I am afraid we are going to wake up one of these days and find that the whole System has only a few district boards and that is it, and then that there will no longer be anywhere in the United States an example of a local PCA or a local land bank. If the Woodstahl plan goes through, there will not be any left in Oklahoma. There will be none. That, of course, changes my feeling about whether I want to fight for that. If there are not going to be any left, why fight for them? So I would hope that you would consider not only following—I think the three policies you outlined are excellent, but I would hope in your saying that you think that the pooling could operate to allow those three objectives to be met, and I agree with you.

But I am concerned that it might not operate that way if you leave it up to the discretion of a system that I see so far out of kilter right now in terms of how it has conducted itself. I would urge you to think of inserting some requirements and additional controls over the System to make sure that those policies were followed and that the owner would only lose the value of that stock as a last resort.

Mr. NAYLOR. Senator, we are working with the Farm Credit Administration and with the System, addressing each of those issues. We understand the sensitivity and the importance of preserving farmer control and their concerns with the ownership of their System.

In fairness to the System, too, we should point out that these assumptions are based on successfully reassuring the market that they can maintain that access, which we believe is very possible. Agency status agencies, as is Farm Credit, as is Fannie Mae, and Sally Mae, have always enjoyed a relatively close spread.

It has only been in the last 60 days that that has broken with the Farm Credit System. We believe it can be returned with prudent action on the part of Congress and the administration working with them. We pledge to work toward that direction and to do it in an equitable and an appropriate fashion.

Senator HAWKINS. I have some recommendations for you. You were not here earlier, but I have been working on this as I have watched this develop on a daily basis by reading the Wall Street Journal. In order to establish a program here that would get the goal that is so worthy that we are talking about, I feel you ought to separate the Farm Credit System institutions from the regulator by establishing financial independence for the Farm Credit Administration.

The way we do that would be to establish a fixed assessment on the Farm Credit System's banks to provide operating funds for the Farm Credit Administration. We already have an example of how that works.

Mr. NAYLOR. That is anticipated in the work we are now doing, Madam Chairman.

Senator HAWKINS. We are all talking about worthy goals of upgrading the standards, the accounting principles, the reporting requirements of the Farm Credit institutions, and it seems to me that the governor of the Farm Credit Administration should become a full member of the Federal Financial Institution Examination Council or whoever we decide is the principal.

Mr. NAYLOR. Madam Chairman, we haven't made that specific provision, but we have certainly incorporated reporting procedures, accounting, and so forth. I see no problem with your last recommendation.

Senator HAWKINS. Well, they talk a lot of about arm's length and we want to give them plenty of arm's length. A goal would be to increase the enforcement authorities of the Farm Credit Administration. They have had that pending since, I think, early this year. Somebody filed what they wanted as their reform for their enforcement. Some of those would be cease-and-desist authority against any institution or officer of the institution. It is important. The FCA will have formal removal power.

We have heard people ask for that today. The FCA will establish procedures for administrative and judicial hearings. The FCA can assess civil penalties for noncompliance with certain orders. The FCA will enforce its orders through the Federal courts, and the FCA can require the merger of two or more like institutions.

Now, those are parts of the things that are floating around the Capitol, but it seems to me they would all be good things to enforce—increase the enforcement authority of the FCA.

Mr. NAYLOR. Indeed they are, Madam Chairman, and I believe all of those are addressed in the work that we are doing with the Farm Credit Administration, the Department of the Treasury, and the Department of Agriculture. We anticipate that perhaps by the end of this week or certainly early next week these major provisions will be worked out in a legislative form which could be used by the committee as a base of reference.

Senator HAWKINS. That is what we need and bottom line improved reporting and the examination process for Farm Credit institutions. We will talk about methods to get there, but it is mandatory that we do that. We prefer, at least the members that I have talked to, to do it legislatively and announce the time.

We thank you.

Do you have any questions?

Senator **Boren**. No further questions.

Senator **Hawkins**. We thank you for your participation here today. I know you have had a grueling day, but not as bad as the court reporter. We thank you so much. The hearing is adjourned.

[Whereupon, at 2:15 p.m., the committee recessed to reconvene at 9:45 a.m., Friday, November 1, 1985, in room 328-A, Russell Senate Office Building.]

EXAMINATION OF THE FINANCIAL CONDITION OF THE FARM CREDIT SYSTEM

FRIDAY, NOVEMBER 1, 1985

U.S. Senate,
Committee on Agriculture, Nutrition, and Forestry,
Washington, DC.

The committee met, pursuant to notice, at 9:46 a.m., in room SR-328A, Russell Senate Office Building, Hon. Jesse Helms (chairman of the committee) presiding.

Present: Senators Helms, Lugar, Cochran, Boschwitz, Wilson, McConnell, Zorinsky, Boren, Dixon, Heflin, and Harkin.

The Chairman. The committee will come to order. We open the hearing today by welcoming our distinguished colleague from Montana, Senator Baucus.

STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator Baucus. Thank you.[1] Mr. Chairman, I want to thank you, as do all American farmers and American agriculture, for taking time today for this hearing. I know that the agriculture bill is occupying your time as well as the time of all the other members of this committee. I know that we all are very thankful for your taking this additional time for this hearing today.

I also am not going to go through the long list of statistics which show the degree to which American agriculture, particularly its financial credit system, is in deep trouble.

Mr. Chairman, I know the members of the committee know that, and I also know that you have been spending much time here, yesterday and today, trying to determine the degree to which the Farm Credit System should receive financial aid to help redress some of the very difficult financial problems that it faces today.

You know the problem is severe, and I know the committee is taking time to address that question. At this point, I am not here to ask the committee to provide additional financial assistance. That is another matter for this committee to determine.

Rather, I am here to address a deeper, more fundamental problem that the System faces, and that is the structure of the financial credit system. It is apparent that if this committee, the Congress, and the Government are going to provide additional financial assistance to the financial credit system, as I believe it must and should, the structure of the System must be changed to provide for the confidence that is necessary in the capital markets, and necessary by borrowers and shareholders. That must happen before we can have a viable system.

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[1] See p. 354 for the prepared statement of Senator Baucus.

It is important to have that confidence in the System, and that confidence now is in question. The capital markets do not have the confidence that they should have in the System, nor do borrowers and shareholders.

I think that is due to basic structural infirmities, basic structural problems in the Farm Credit System.

I introduced a bill, S. 1790, to help redress those structural problems. I am sure other Members of the Congress will have other ideas as to how the structure should be redressed.

It is my belief, and the belief of, I think, most shareholder/borrowers, members of the System, that any restructuring has to have at least two essential ingredients.

First, any restructuring must not only retain but strengthen local control of shareholders and borrowers in the Farm Credit System. Today, one of the problems is that they do not have that local control. They have it in name but not in fact, and I think that any system that is going to be viable and strong has to have the confidence of the local shareholders, of the local borrowers of the system. That must be addressed, and my bill helps to address that. Second, and in return for a greater local shareholder control, there has to be, I think, a stronger financial discipline in the System.

I suggest, and the bill I introduced suggests, setting up a kind of FDIC for the Farm Credit System and requiring that generally accepted accounting principles be adhered to by the System. Beyond that, my bill would require annual audits, and publication of financial statements. It seems to me that if we are going to have the kind of System that has the confidence of not only borrowers in capital markets but of the American people, the System must enforce rigorous financial standards, similar to what we now have with the banking system, similar to S&L's and other financial institutions.

I urge this committee, to address that core of problems that we now face with our Farm Credit System. There are other provisions in the bill, and other panelists this morning will go into those provisions in greater detail, but I strongly encourage this committee, Mr. Chairman, to keep and enhance local control, because that is important for local confidence in the System. Second, I urge this committee to strengthen the financial accounting and regulatory practices of the System, by setting up an FDIC, and requiring adherence to generally accepted accounting principles, audits, and publication of financial statements.

Mr. Chairman, I would like to insert at this point a summary of my bill.

[The summary referred to by Senator Baucus follows:].

SUMMARY

A. LOCAL LEVEL GOVERNANCE CHANGES

(1) Give each of the 36 banks in the system its own five-member board of directors elected by the shareholders of that bank (leaving the Central Bank for Cooperatives unchanged).

(2) Make the district farm credit boards advisory and reduce the number of directors to five: one from each of the three bank boards and two elected directly from the farmer-rancher borrowers.

(3) Require use of generally accepted accounting principles (GAAP accounting) by the banks and associations in the system, require certified public accountant audits at least yearly, and require publication of the financial statements of each of the banks and associations.

(4) Restore to the banks and associations management responsibility, by returning to them most of the "prior approval powers" now vested in the FCA.

B. REFORM AT THE NATIONAL REGULATORY LEVEL

(5) Create a Federal Farm Credit Insurance Corporation [FFCIC] with a three member-board appointed by the President with the advice and consent of the Senate, which would have

(a) cease and desist powers against unsafe and unsound agricultural banking practices,

(b) a fund created by an initial transfer of reserve assets from present system institutions to the FFCIC in exchange for non-voting shares (at an initial level of $2.25 billion, with further assessment rights if needed), and

(c) the responsibility to insure the 37 banks and the existing associations against illiquidity and against impairment of capital, through use of the fund, by means of loans, grants or guarantees to system banks and associations, but with ultimate responsibility to liquidate system institutions (as a Congressionally disfavored last resort) in order to avoid severe impairment of the FFCIC fund.

(6) Eliminate nonbanking activities from the Farm Credit System, leaving in place the 37 banks, the existing land bank associations and production credit associations and the Federal Farm Credit Banks Funding Corporations.

(7) Statutorily prohibit forced merger of associations or banks (while retaining the right of associations voluntarily to propose mergers of like associations).

(8) Make the Federal Farm Credit Board advisory, with its chairman to be appointed by the President.

(9) Sunset the Farm Credit Administration (having (a) returned much of FCA's "prior approval" involvement in management to the banks and the associations, and (b) transferred to a new FDIC type regulatory/insurance agency FCA's residual regulatory power).

C. ADDED TOOLS TO HELP AGRICULTURE

(10) At the FFCIC level.—Statutorily permit the FFCIC to lower the capital requirements for system institutions across the board to not less than ½ of 1 percent more than the capital requirements applicable to national banks.

(11) At the local bank and association level.—Grant authority to the primary lending institutions in the System, as an alternative to foreclosure, to take title to collateral and lease it back to the debtor, or other viable operator, with the value of the collateral to be includable in the statutory collateral requirement for the issuance of bonds, this function to be specially subject to regulation by the FFCIC which may charge differential premiums in connection with risks growing out of this function.

D. TRANSITION PROVISIONS

(12) Provide appropriate transition provisions including (a) an effective date for sunset of FCA and creation of FFCIC ninety days after enactment, (b) continuation of FCA regulations for a temporary period of six months or until promulgation of interim or final FFCIC regulations, whichever is earlier, and (c) asset transfers to FFCIC from sunsetted entities.

The CHAIRMAN. Thank you very much, Senator. I think he qualifies as an honorary member of this committee. All in favor say aye.

[Chorus of ayes.]

Senator BOSCHWITZ. Hold on now, Mr. Chairman. That would make nine and nine. I mean——

The CHAIRMAN. He cannot vote. [Laughter.]

Senator BAUCUS. Thank you.

The CHAIRMAN. Thank you, Max.

Well, yesterday we heard from the administration, the Farm Credit Administration, and the Farm Credit System on the current financial difficulties of the System, and proposals to address them.

Obviously, there are differences of opinion, as there always are on such complex issues, but I do believe that we achieved a better understanding of the nature of these problems and how we might proceed to deal with them.

Today, we are going to hear from witnesses to follow up on testimony heard yesterday, and to discuss other aspects of the Farm Credit System. As I believe I stated at our previous hearing, our primary goal in the consideration of these issues must be to ensure that adequate credit is available at affordable interest rates.

I look forward to hearing from our witnesses this morning and I appreciate their efforts in coming here to bring these important issues before the committee.

Now, if the committee will indulge the chairman, just for old time's sake, I want Hubert Humphrey to sit in that chair right there, again.

Hubert, if you will go over there. This is the son of the distinguished former colleague. We welcome you. There are four witnesses on this panel. Mr. Humphrey is attorney general, as you know, of the State of Minnesota. We have the Honorable Thomas Miller, attorney general of the State of Iowa.

We have the Honorable Neil Hartigan, attorney general of the State of Illinois, and Miss Sarah Vogel, assistant attorney general, State of North Dakota.

Why don't we put one more over there and one on either side of Senator Lugar there, and we will proceed.

Senator BOSCHWITZ. I might say, Mr. Chairman, that I welcome our attorney general here. I hope he does not get to like it too much, develop a yen for this place, or something. But nevertheless, he serves with great distinction in Minnesota and brings additional great honor to the name that he bears, and has been a leader in many things, including the business of agricultural credit.

I have worked with him on a number of issues, and while we are on different sides of the political fence, we have had no problem working together, and as a matter of fact, have come to pretty good conclusions. So, I do welcome him here and I think he will have meaningful things to say to us about farm credit.

Senator DIXON. Mr. Chairman, may I also indulge myself by expressing my personal satisfaction in introducing to this panel my warm and dear friend, the attorney general of Illinois, Neil Hartigan, who has distinguished himself in many public positions in our State.[1]

He has been Lieutenant Governor of Illinois. He is attorney general now. He is a candidate for Governor of our State at this time.

He has been a lifetime friend of mine and I am privileged to introduce him to this committee.

The CHAIRMAN. I say to Attorney General Miller, Assistant Attorney General Vogel, that their Senators will be here shortly, and if they are not, they will regret it.

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[1] See p. 333 for the prepared statement of Senator Dixon.

So, we will proceed in the order listed on the agenda, if that is appropriate. Mr. Humphrey, you may proceed.

If you wish to summarize or extrapolate, or whatever, that will be fine. Any prepared statements will be printed in the record. We try to stay as informal as possible in this committee and within the time restraints that we are obliged to observe.

So, you may proceed, sir.

STATEMENT OF HON. HUBERT H. HUMPHREY III, ATTORNEY GENERAL, STATE OF MINNESOTA

Mr. **HUMPHREY**. Thank you very much, Chairman Helms, and I appreciate very much the comments from Senator Boschwitz, and running against the Humphrey genes, I will have no comment with regard to his thought about whether or not I would like to enjoy this area a bit longer.[1]

Senator **BOSCHWITZ**. The summers are terrible. [Laughter.]

Mr. **HUMPHREY**. Mr. Chairman and members of the committee, I listened very carefully to the charge that you have been given, as you consider very serious concerns about the Farm Credit System.

I serve along with other members in our national association and I serve as chairman of the Agriculture and Rural Legal Affairs Committee.

Eleven Midwest attorneys general came together and began working on common concerns arising out of literally thousands of complaints that come from the people who use the System, the borrower/shareholders, and our response, and our review today, is premised upon a letter which we together forwarded in a bipartisan manner to Governor Wilkinson, and we would just like to briefly outline some of those areas of concerns.[2]

Indeed, it is an extremely important one, as I am certain you are well aware of. As you consider those credit concerns, we have to deal with the complaints that have been raised as to how the practices of the System seem to be affecting those individuals.

I want to talk to you about just one area, and that is this idea of fairness and the right of review. The issue we are talking about here really is fundamental fairness to the farmer/borrower, and there are two facets, Mr. Chairman, of this point.

First of all, we need to see that the Farm Credit System give ample notice of adverse credit decisions, and also, a right of review of those decisions, independent of the original person who is making those decisions. So, the sense of fairness comes forward all the way to the farmer/borrower.

We also need to see that the System adheres to the letter and spirit of its own regulations, that is, in its local practices. Let me give you just one example.

A Minnesota farmer, for 15 years, has had a good record of steady, on-time payments to his local PCA. He got 1 month delinquent, 1 month behind schedule, and immediately received the accleration notice from his local PCA, got the 15-day notice for the acceleration.

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[1] See p. 355 for the prepared statement of Mr. Humphrey.
[2] See p. 357 for a reprint of the letter to Governor Wilkinson.

Now, he received that 15-day notice only with 3 days left for that 15-day period. The good news is, Mr. Chairman, he was able to renegotiate the loan.

The bad news is, that when he renegotiated the loan, he was charged an additional 2.8 percent interest increase because he was then determined to be a problem borrower.

Now, there is good news again. He brought it up to date. He is back in the business of being a good farmer/borrower.

But the bad news is, when he requested to have a review to have his loan rate lowered, the PCA refused to look at his classification and he continued to be a problem borrower, and that was determined to be an indefinite status and not reviewable by the local board.

This kind of example shows how the practices violate, really, all notions of fair play, that there is lack of sense of fair play that is going on, and the effect is that it takes out people who can survive in these tough times, who are able to pay—it forces them out of the System because of these harsh, unfair, inconsistent practices.

The results are really that it is not in the public's best interest, it is not in the farmer's best interest, it is not in the Farm Credit System's best interest, and it goes contrary to the purposes of the Farm Credit Act.

Now, the System fails also to adhere, as I said, to its rules and regulations, and let me give you one other example, and by this I say just that it does not practice what it preaches.

The System has rules and regulations to establish, has established principles of land appraisal, but the practice is not to use those standards. Instead, the practice is to use a benchmark farm system.

In Minnesota we have over 97,000 farmers in 87 counties. What the benchmark system goes on to do is, it uses, instead of a broad-based appraisal system, only 33 benchmark farms in 28 counties to determine the appraisal of all of that collateral, and in Minnesota, over 50 percent of the land that is collateralized for farm purposes is in the Farm Credit System.

So, in these tough times, when tough decisions have to be made, we have a system that is not exact, is not given a sense—first of all, it does not appear fair and it is not fair, and it is inconsistent as to how it is applied.

So, Mr. Chairman, I believe that whether or not any financial assistance is given, or any bailout is made of the System, we must have these kind of practical reforms in place, and I think it is appropriate for the Congress to consider this, and, it is appropriate because time is of the essence.

Our other concern, as law enforcement officials in our States, is that we are aware that there are either the con artists out there taking advantage of these hard times, or there are those individuals who actually do want to preach and breathe violence, and they feed upon this lack of sense of fairness.

We would like to see Congress take some action, if they can, as they consider this, to help us, and help farmers in the process make the System more secure.

The CHAIRMAN. Mr. Attorney General, a very fine statement. You bet ya, as your Daddy used to say, we are looking into precisely that sort of thing.

Mr. Miller from the State of Iowa.

STATEMENT OF HON. THOMAS MILLER, ATTORNEY GENERAL, STATE OF IOWA

Mr. MILLER. Thank you very much, Mr. Chairman.

The element that I want to talk about of the five fairness elements that the four of us are concerned about is forbearance.

We believe that the System should have a fair policy concerning forbearance, and that it should be enforced uniformly throughout the System.

We think that policy should contain probably two elements. One, that if the farmer is behind on payments, it is beyond his control, and that there is some hope in the future of being able to make the payments.

We think in that setting, foreclosure should not occur but forbearance should. And we all have seen examples from around our States where people miss one payment, and then have foreclosure.

That does not make any sense in terms of fairness and it does not make any sense in terms of an effective system, from the Farm Credit System point of view.

We have also run into a related problem where the System would ask for additional collateral from family members, usually parents, and, with the underlying assumption that foreclosure would not take place in the near future, that there would be help on operating loans, at least for the next year.

Then 1 month or 2 months after they have gotten the additional collateral, that they really had no inherent right to, from parents, then they start foreclosure on the parents' property as well as the son's property.

We just think that that is not fair, and that that should not happen in a system like the one that was designed for farmers from its inception.

We in Iowa have a farm division in our attorney general's office, that is patterned after the traditional consumer protection division that you are familiar with probably in most of the other States, and we hear complaints, as a result, from farmers, when they think that they have been treated unfairly, when they think they have been cheated.

We try and keep an eye on those complaints in terms of the variety, in terms of the substance of them, and we noticed that there was a tremendous amount of complaints directed at the Farm Credit System.

We looked at the statistics in Iowa, and the statistics are these: That Farm Credit holds about 40 percent of the land debt and about 15 percent of the operating debt, so we are getting 80 or 90, or maybe even a little more percent, concerning Farm Credit as opposed to the other commercial lenders. So, we thought there was a problem. We checked with other States: with Minnesota, with North Dakota, with Illinois, and the other Midwestern States, and they were saying the same thing—a high number of complaints concerning Farm Credit, the same sort of problems that we have accumulated into our five-point proposal.

That something out there was happening that should not be happening; that there was not fairplay for farmers.

That is why we wrote the letter to Governor Wilkinson and I think we have supplied the committee with, and that is why we are here today.[1] We are here today to make an appeal to you, that whatever legislation is drafted for the Farm Credit System, that basic reform be put in place so farmers are treated fairly.

This is the opportunity to say to the Farm Credit System, "This sort of thing has to stop", and we hope that you do that.

We have provided some draft legislation that we would like to share with the committee, and its staff, that we think would accomplish some of the things that we are talking about, and, in the end, we are not talking about penalizing the System or putting an onerous burden on the System.

We are talking about some simple and fair ideas that really are in their long-range best interests, Mr. Chairman, and we appreciate your consideration of our views.

[The following material was subsequently received by the committee:]

DRAFT—PROPOSED AMENDMENTS TO THE FARM CREDIT ACT

I. DISCLOSURE OF LOAN TERMS

A new provision (adapted from the Truth In Lending Act, 15 U.S.C. §§ 1601-1667c, and Regulation Z, 12 C.F.R. part 226):

(*A*) *General disclosure requirements.*—(1) *Content of disclosure.*—For all proposed loan agreements, Farm Credit System institutions shall disclose the following information as applicable:

(*a*) *Annual percentage rate.*—This rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the consumer to the amount and timing of payments made.

[NOTE.—This definition is taken from Regulation Z, 12 C.F.R. § 26.22.]

(*b*) *Annual percentage rate including cost of stock purchase.*—The cost of the stock purchase required on association and bank loans should be figured as a cost of credit and designated as a separate rate.

(*c*) *The impact of variable interest rates.*—If an institution uses a variable interest rate program, it must disclose the formula by which the rate is determined and the impact on the borrower of changes in the variable rates. In addition, the Farm Credit Administration shall promulgate regulations establishing or requiring the institutions to establish standards for the use of variable interest rates including: a formula or formulas under which the interest rate is determined; a maximum interest rate increase for a single year and for the life of the loan; and that borrowers will be given 30 days notice before any increase in the variable rate.

(*d*) *Policy in regard to default.*—The disclosure of the policy in regard to default shall include: (1) the circumstances which may constitute default; (2) that failure to cure a default may result in acceleration and foreclosure; and (3) the policy regarding forebearance.

(*2*) *Form of disclosure.*—The disclosures required under subsection (1) of this part shall be made before the loan agreement is finalized.

(b) The lender shall make the required disclosure clearly and conspicuously in writing, in a form that the borrower may keep. The disclosures shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related to the disclosures.

(c) The disclosures shall be written in a clear and coherent manner using words with common and everyday meanings and shall be appropriately divided and captioned by its various sections.

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[1] See p. 357 for the above referred to letter.

(d) The annual percentage rate and annual percentage rate including the cost of stock purchase shall be disclosed consecutively.

[NOTE.—This provision is adapted from the Truth In Lending Act, 15 U.S.C. § 1638(b) and Regulation Z, 12 C.F.R. § 226.17.]

II. ACCESS TO DOCUMENTS AND INFORMATION

A new provision:

The Farm Credit Administration shall promulgate regulations requiring banks and associations to provide borrowers with all documents material to the loan transaction, at the time such documents are executed or upon request, including, but not limited to the contract, mortgage, financing statements, and cash flow statements; and further requiring banks and associations to provide stockholders, upon request, with articles of incorporation, by-laws, local rules and policies, and loan manuals.

III. FAIRNESS AND RIGHT OF REVIEW

(A) Amend 12 U.S.C. § 2201 to read: § 2201 Notice of adverse credit decision.

Every loan applicant and borrower shall be entitled to prompt written notice of any adverse credit decision, the reason for such decision, and the right to review of the decision under section 2202.

(B) Amend 12 U.S.C. § 2202 to read: § 2202 Review of adverse credit decisions.

The Farm Credit Administration shall promulgate regulations, requiring each institution's board of directors to establish, from among its members, a credit review committee. Any loan application or borrower who has received notice of an adverse credit decision may, if he so requests in writing within thirty days of receiving such notice, request review of the adverse credit decision, in person before the credit review committee. Promptly after such a hearing, he shall be notified in writing of the credit review committee's decision and the reasons therefor.

IV. APPRAISALS

A new provision (adapted from 12 CFR § 614.4220 (a) and (b)):

Primary real estate security shall be valued on the basis of appraised value. Appraisal value is the reasonably supported market value, that is, the amount which a property will bring if a reasonable time is allowed to find a purchaser and if both seller and buyer are fully informed.

V. FORBEARANCE

A new provision (adapted from 7 U.S.C. § 1981a):

Pursuant to regulations, the Farm Credit Administration shall establish a procedure under which a borrower may request the deferral of principal and interest upon a showing by the borrower that due to circumstances beyond the borrower's control, the borrower is temporarily unable to continue making payments of such principal and interest when due without unduly impairing the standard of living of the borrower. The borrower shall be provided with written notice of the availability of deferral: (1) at the outset of the loan term; (2) at the beginning of each production season; (3) when a borrower is notified that he is delinquent; and (4) when a borrower is given an acceleration notice. The regulations promulgated pursuant to this section shall include a policy encouraging Farm Credit System lenders to work with other lenders and suppliers to resolve the fiscal difficulties of financially troubled borrowers. The regulations shall also incorporate special consideration for the preservation and maintenance of family living and farm operating expenses and collateral.

VII. CLAIMS AGAINST STOCK

Add to 12 USC §§ 2034 and 2094(f):

If the loan is in default, stock may be canceled for application on the loan only upon written notice and a right of review pursuant to sections 2021 and 2022 of this chapter.

VIII. LIQUIDATION OF INSTITUTIONS

Add to 12 USC § 2183(b):

Said regulations shall, among other things, direct institutions to ease the borrower's transition when a liquidation occurs, including, whenever possible, flexible financing for required new stock purchases, such as extending the time period in which such purchases may be made.

The CHAIRMAN. Thank you very much. Well, we have a roll call vote on. I have not yet seen the draft legislation. We must bear in mind, of course, that the local farm credit associations are owned by borrower/members, and as such are members of the private sector, but, of course, regulated by the Farm Credit Administration.

Well, we will take a look at that. Now the third on the list—why don't we do one more. We have 15 minutes before a rollcall vote. Let's go with Mr. Hartigan and maybe we can get both of them by the time we have to leave.

The distinguished attorney general, State of Illinois, Mr. Hartigan.

STATEMENT OF HON. NEIL HARTIGAN, ATTORNEY GENERAL, STATE OF ILLINOIS

Mr. HARTIGAN. Thank you very much, Mr. Chairman, Senator Dixon, members of the committee. My colleagues, Attorney General Humphrey and Attorney General Miller have touched on two of the areas. An area that I would like to speak to is the question of full disclosure. The three of us, and eight other attorney generals on a bipartisan basis, as has been pointed out, came together because of the severe problem that we are confronted with in our States.

We lost 4,000 family farms, Mr. Chairman, last year in Illinois, the second worst in America. Fifty-two percent of our agricultural credits are in this System, and the idea of fairness, of people being viewed as investors as opposed to adversaries. Frankly, being served on a fair basis is something we think is terribly important. If there is in fact to be substantial moneys made available to the System, an element of making that available, we hope, will be the inclusion of these reforms as far as the fairness aspect is concerned.

With respect to truth in lending, truth in lending of course is, agriculture is exempted from it at the present time. The System is treating these people, including many of the 4,000 family farms that were lost, like they are commercial borrowers. They are not commercial borrowers.

Many of them are small family farms, medium-size family farms. They need the fairness that a truth in lending or regulation Z would spell out. Circumstances under which the interest rates may increase; limitations in the increase; the effect of any increase on the operation's cash-flow; an example of the payment terms that would result from any increase; advance notice of any expected increases in their interest rates. We are suggesting a 30-day minimum.

Disclosure of a formula for determining the variable interest rates. Oftentimes they do not even know that there is variable interest rates involved and what, in fact, the impact of that can be on them. The idea of the annual percentage rate that would include the 10 percent of stock that they have to purchase if they are going to get a loan from the PCA or the 5 percent from the FLB.

Those are real facts for people who are not commercial lenders; they are family farmers. We expect them to do everything on the face of the Earth, including being an economist, at the same time that they are trying to grow their crops in a very difficult area.

We think that there should be the 30-day notice. That when there are mutiple rate levels, that that should be explained, and explained carefully, on the front end. The policy and procedures in the event of default.

Anything that any commercial lender would know as a professional matter does not mean that the individual family farmer is going to know that.

We think they should be carefully explained. A declaration of disclosure of the 3-day waiting period. The fact that they do have a right to legal counsel, and that there be some consistency.

We think that it is important that control remain at the local level. We have 37 systems within Illinois right now. That is healthy. They know the local problems. But there should be a consistency across the board. The documents being available. Simple, common sense things that, frankly, just are not happening in too many cases. They have had literally a couple of thousand cases in their States and what they are talking about here is prevention, you know, literally, of valid alternatives, because of the level of frustration.

When we meet with the people involved in the System, they do not have the faintest idea that this is going on in the real would, you know, on the ground in Iowa, in Minnesota, or Illinois.

So, we think that the leverage that the Federal Government has now in terms of the financial questions that are involved make this really the commonsense opportunity for fairness to be in the System.

You know, these people are not serfs. These people are investors. They put their hard-earned money into these institutions, and they are entitled to simple decency and fairness, and that is what we are here for, to try, as the chief legal officers of our States, on a bipartisan basis, the 11 that came together reflect all political philosophies.

The common denominator is full, open disclosure and fairness, and commonsense. Thank you, sir.

The CHAIRMAN. I tell you, we have some eloquent people here this morning. [Laughter.] Now the piece de resistence——

Mr. HARTIGAN. Mr. Chairman.

The CHAIRMAN. Yes.

Mr. HARTIGAN. May I add one thing before Senator Dixon leaves. We ask Senator Dixon, and my colleagues are asking the Senators from their States, if they would be good enough to review these proposed amendments that we have presented to the Chair and be sponsors of the amendments because the bipartisan strength of the question we think is involved here, and the Senator has been good enough to spend some time with me, and with us, and we look forward to his continuing support. Thank you.

The CHAIRMAN. Very well. Now the distinguished assistant attorney general of the State of North Dakota, Miss Sarah Vogel. We welcome you.

STATEMENT OF HON. SARAH VOGEL, ASSISTANT ATTORNEY GENERAL, STATE OF NORTH DAKOTA

Ms. VOGEL. Thank you. I am here on behalf of Nicholas Spaeth, the attorney general.[1] I have brought three specific examples from North Dakota to illustrate some of the points made by the attorney general.

The first part has to do with the actual language in the notes that the farmers are requested to sign. In 1979, the Federal land bank promissory note might have said 8 percent. Underneath, it said "or any other rate that we may choose to charge some day."

PCA promissory notes have the same type of language except their initial note does not even say what the basic rate is. Not even that. The PCA borrowers do not know what the repayment terms are.

There is a very long paragraph, but the bottom line is, the people have to pay the PCA whenever the PCA loan officer says.

This is not fair, there is no notice, and if somebody buys a herd of cattle that cannot pay itself out, unless over a 3-year period, they should be given some kind of right in that context and not just be subjected to a loan which you do not know what the interest rate is going to be, and you do not know what the repayment terms will be. The proposed legislation will do much to address that.

The second example I brought is with respect to the ability of the farmer member borrowers to obtain information.

The State of North Dakota has a credit review board, a State agency which helps farmers negotiate loans to try to save the home quarter. They wrote to every PCA and every Federal land bank association in the State asking for copies of the forbearance policies and for the debt compromise policies, which these institutions are required by regulation to have.

To my knowledge none of the PCA's responded, a few of the Federal land banks did, and I have attached a letter from the Fargo Federal Land Bank Association saying, to this State agency, "It's our policy not to reveal these things." I submit to you that if a State agency cannot get this information on forbearance policies a farmer cannot. How is a farmer to determine if he is being fairly considered under a forbearance policy, if the lender will not even tell him, or anybody, what it says?

It cannot be done. It is unfair.

The third example I brought has to do with farmer-stockholder rights, the rights of the stockholders to elect their boards of directors, and to vote.

In North Dakota, in March of this year, after a series of losses due to a long-term drought, St. Paul Federal Land Bank decided that the Fargo Federal Land Bank Association and the LaMoure Federal Land Bank Association should merge.

The local board members had no objection; however, St. Paul said the "price" for the merger was that the LaMoure Federal Land Bank Association's, entire board had to resign en masse.

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[1] See p. 367 for the prepared statement and additional material of Mr. Spaeth.

These board members felt that that requirement was not fair to the people who had elected them and said no. Thereupon, St. Paul fired them all.

There was an annual stockholders meeting scheduled for March. Before the election, in violation of their regulations, they wrote to every stockholder and said, "If you reelect the old board we'll fire them again."

They got together the night of March 28. There was a blizzard outside. They had guards with uniforms and a very threatening appearance at the doors; they kept people outside in a blizzard until the time the meeting was to start, which was highly unusual, at the LaMoure high school gym. When the meeting started, they had decided that somebody from Wisconsin would run the meeting.

A motion was made from the floor saying that the stockholders had not come to hear the "gospel according to St. Paul" and they wanted to have one of their own people run the meeting.

That motion passed by an overwhelming margin. The stockholders nominated the old board; they nominated an alternative slate. The old board got elected by 80 percent, or more, by acclamation.

St. Paul was able to give their entire speech. There was total democratic participation. St. Paul was allowed to say everything it wanted to say; it lost on everything.

At the end of the meeting, after the bulk of the farmers had left, the St. Paul officials handed out a letter to the democratically elected board which I have attached to my testimony as Exhibit 4.[1] It said, "This is to advise you that effective immediately, the Federal Land Bank of LaMoure is expressly prohibited from taking any action without the express prior permission of St. Paul." It went on to hold those locally elected directors to personal liability, should they do anything. The letter further stated that St. Paul was going to hold the board members responsible not only for their own legal expenses but St. Paul's as well. St. Paul also filed a lawsuit against the board members within several days. This experience in LaMoure, North Dakota does not coincide with the Farm Credit System advertisements which they have been sending out all over North Dakota saying, "We stand by our commitment to farmer ownership and direction. We do so without reservation." [1]

The Farm Credit System is spending probably hundreds of thousands of dollars on advertising, but their actions do not coincide with the advertisement. It is not right, and if Congress were to provide Federal assistance, then I think that the local control of stockholders is an important feature to retain.

The **Chairman**. Thank you very much. I think it can be safely said that you and I prefer the original St. Paul. [Laughter.]

The committee will stand in recess for just a couple of minutes until Senator Zorinsky gets back, and I would ask staff to arrange for the next panel.

Let me depart by saying that it has been a pleasure to see you this morning. I am very impressed with your testimony. We appreciate your help, and have a safe trip home.

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[1] See p. 376.

Mr. HUMPHREY. Mr. Chairman, I also want to offer on behalf of our working group, and we do have a staff that works together—we would be more than willing to offer that staff to work in coordination with your staff, and in regard to any of these matters.

The CHAIRMAN. As your dad would say, you've got a deal. Thank you.

[A recess was taken.]

Senator ZORINSKY [presiding]. The committee will come to order.

Senator BOSCHWITZ. Mr. Chairman, I hope we are going to be able to ask questions of the attorneys general. I see that they are packing up and leaving.

Senator ZORINSKY. Would the members of the previous panel representing the attorneys general offices of all the States please return to the table. Senator Boschwitz, you may begin.

Senator BOSCHWITZ. Thank you, Mr. Chairman. I am sorry that I missed Miss Vogel's testimony, and I read a part of it on the way over, and a part of it on the way back, and I am interested in what I hear from these folks because they take a different view, or they look at it from a different viewpoint than we do, a more practical view perhaps.

For instance, I believe Mr. Miller said that people get collateral from third parties like parents, and then, shortly thereafter are foreclosed. Is that a common practice?

Mr. MILLER. A fairly common practice. It should not happen at all.

Senator BOSCHWITZ. Why shouldn't it happen at all?

Mr. MILLER. Well, because I think that when they go to get collateral from parents, third parties, there is an underlying assumption that they are going to work with the borrower for awhile.

I think that is the natural and inherent assumption of that request, and then when the collateral is given, foreclose in 1 month or 2 months, before extending another year of operating loans, I think is inherently unfair.

Mr. HARTIGAN. We had a situation in Illinois, Senator, where the PCA, I think was urging them to buy—they made the loan available to buy 300 head of cattle, and then, 1 month later, they came back and canceled the other loan that they had, so they did not have any way to feed the cattle. They were urging them to overextend themselves in effect, and then taking away the ability to meet the obligation.

There are also incentives which we said in our letter to the Governor, which we saw as a conflict of interest. These incentives, during the 1970's, to go out and extend as much credit as possible, with incentives being given to the loan officers for the extension of the credit—trips, vacations, what have you, as incentives to do it. Then all of a sudden when the System starts to get in trouble, the people who can least afford it are the ones that get muscle.

I mean, you know, the idea was it was their bank, and they are the ones that are in, the investors, and then they are turning around with them, on them, with these policies to put it to them.

You know, that is not fairness.

Ms. VOGEL. Senator Boschwitz, with respect to the parents, and so forth, the way that usually happens is they write the debtor a loan, and they say, "You're a little undercollateralized, and to put your loan back in good standing you need a little more collateral."

The implicit and even explicit assumption is, that with that additional collateral, then you are going to be in good shape. To turn around 1 month later, or something like that, and foreclose, not just on the son but on the parents, causes great hardship and heartbreak. At one meeting, where I spoke, three separate retired fathers came up to me, all being sold out, and two of them were crying. I could not believe it. That is the saddest thing you will ever see.

Senator BOSCHWITZ. Is that fairly common? How many times have you experienced that?

Mr. MILLER. I think in Iowa we have probably had 10 or 15 such examples that we have heard of, but we do not hear of all of them.

We talk to the other States and they say the same sort of thing in their States. It is not an isolated example. It is a way that at least, all too often, they try and deal with a bad situation by misleading people.

Senator BOSCHWITZ. I certainly agree that the assumption should be fairly made, and I presume that the people should reasonably protect themselves. Apparently they do not all do it and they operate as friends, and I can understand that kind of relationship.

Mr. HUMPHREY. Mr. Chairman, if I might just add. There are a number of circumstances that aggravate what people would normally assume is a borrower and a lender coming to an understanding in these very tough circumstances, and let me give you an example.

In our State we have now pulled together the bar association and the attorney general's office working on a task force to try and figure out how to get better legal services throughout rural Minnesota.

One of the very serious problems is that when the borrowers come in, they do not traditionally look to have a lawyer sitting next to them.

They have relied upon the loan officer to be their friend, to be their guide, and to be their financial adviser.

Now, under the more adverse circumstances where tough decisions have to be made with regard to credit, they find out that the person that is sitting across the table is not necessarily their friend and has all the resources of CPA's and attorneys, and everything.

The borrower, No. 1, does not know who the attorney should be, and second, when they finally find a competent attorney who understands bankruptcy laws, who understands what the Farm Credit Administration is in the local community, it is the lawyer that is representing the bank.

So, they are at an information and an advisory disadvantage when they come into that set of circumstances. That is why I think we are suggesting that there ought to be more of this openness and disclosure.

The idea of having that little extra collateral is implicit but sometimes explicit, that those parents will only have to give a little bit of collateral. Yet, when you read the details of the documents, which they either do not read or may not even have seen, they find out that their entire assets, of the parents, are collateralized with the other loan, even though it may not have been necessary to collateralize that loan.

So, when the foreclosure proceedings occur, it occurs on all of it. And what it does is it adds to that sense of frustration, unfairness, and frankly, the idea, and the sense that is pushed by some individuals, of conspiratorial attitude.

It is a dangerous attitude that we, working with our law enforcement people, are concerned about.

Senator ZORINSKY. I have signed a lot of notes and mortgages and other things in my day. I must tell you that I have been in the same kind of situation from the standpoint of not reading all the fine print and probably being obligated to a larger degree than I had anticipated, but always thinking that I was going to be able to meet my obligations.

So, it did not matter if I signed or did not sign. But you four gentlemen—what have you done in your States to inform farmers that these kinds of practices are going on and that they should consider seeking legal counsel?

Mr. HUMPHREY. Mr. Chairman, may I just indicate that it is of such major proportions in Minnesota, this disparity of available legal resources, that we have mustered all of the support of the experts from our three law schools and others, and really, I have to indicate that I'm sure it is somewhat like that in every other State.

The other point is that each of the examples that we have given are a response to inquiries made to our office, and many times the only way that individuals have obtained documents is by the pressure of literally the attorney general of the State coming down hard and saying: "We're going to court. We're going to muster all the support we possibly can unless you give over those documents."

And many times it is just the documents that the people have signed, not any of the other documents.

There seems to be this sense that they cannot disclose and we think it is good business practice for people to be able to negotiate on a common understanding of the base.

Mr. MILLER. We have formed a working group, the group of our States, to try and work on these problems, and one of the things that have come out of the working group has been done in Iowa, and other States, and that is, to work with the bar association, to have seminars, and have continuing legal education to bring lawyers up to date, so that they can handle these problems more and more for people throughout the State.

We feel that has been an important contribution, but we feel in addition we should go to the source of the unfairness and try and get it stopped there as well.

Senator BOSCHWITZ. Well, I have no disagreement with that. You also make every week a 5-minute radio tape and see that every radio station in your State gets it. Not too bad a political move, but quite aside from that, make sure that you get to the real source which is the farmer, and tell him, "You ought to obtain legal counsel" and that times have changed, and his friends at the bank—you know, my banker used to give me unlimited credit, and then things got a little bad in my case as well, so suddenly, they wanted me to sign all kinds of guarantees, and boy, I tell you, I fought them.

Maybe I am a little more sophisticated than some of the folks that the Farm Credit System is dealing with, but frankly, I find the farmers to be relatively sophisticated businessmen and borrowers.

Mr. HARTIGAN. That is true, Senator, but in terms of access to the documentation and awareness——

Senator BOSCHWITZ. I cannot believe that——

Mr. HARTIGAN. Yes, but it is true.

Senator BOSCHWITZ. I mean a bank—is there a course in the banking relationship?

Mr. HARTIGAN. It took 30 days for 11 attorneys general to even get a meeting on this, the documented letter that we sent. Yesterday, at 4 o'clock was the meeting, and it was probably at least in part because we were coming here today.

Mr. HUMPHREY. You are a good audience, Senator, and we thank you. That was a good constructive meeting.

Mr. MILLER. We would note that it was a very good meeting. We had a good discussion. I felt we made some progress.

Senator BOSCHWITZ. I was on the floor of the Senate with the farm bill so I am sorry that I was not there. But you find from your experience that——

Mr. HARTIGAN. One of the other problems, Senator, is access to legal services. The farmer who is already in trouble, and who is trying, as a layman, to deal with an institution that is functioning in an obstructionist manner to start with, then tries to get the lawyer. When you are on the verge of bankruptcy, oftentimes, what we are finding is, where do you come up with the $5,000 retainer? We copied. Attorney General Miller set up the first agricultural division in an attorney generals office in the country. We copied it in Illinois. We tried, through our regional offices, to put lawyers there that had skills in agricultural law and bankruptcy law, to try and help out.

But the reality of the situation is that they do not have the money, they are already in trouble, and they cannot function as laymen on a competitive basis because they are not commercial entities.

It is not that they are not good, solid, intelligent people, but, you know, when you get to the fine print and you are in trouble, you need a lot more than good solid intelligence.

Senator BOSCHWITZ. You have to arrive at the lawyer's office with $5,000 in hand?

Mr. HARTIGAN. We found that in Illinois, yes. When you are talking about a situation like this and you have got a bankruptcy possibility confronting you as well, that that is the situation.

The legal assistance programs that we put through our legislature were on that basis. The rural route people came to us. The rural route people said: "Look. We can counsel farmers in trouble on the economic side and social problems——

Senator BOSCHWITZ. The who? Rural route?

Mr. HARTIGAN. Route, yes. They are part of the extension service of the University of Illinois that has done a terrific job in Illinois, but they said, "We're not lawyers. We can't help the people out in that part of the problem."

It is a severe problem. Frankly, this is the response that we got yesterday. Read that and——

Senator BOSCHWITZ. Do I have a copy of that?

Mr. HARTIGAN. I will give you this copy. You will think you are on Mars.

Senator BOSCHWITZ. Well, I must tell you that I listened to Mr. Wilkinson's testimony yesterday, and I kind of agree with that assessment.

Senator ZORINSKY. Would the Senator from Minnesota yield to me for a question?

Senator BOSCHWITZ. Surely.

Senator ZORINSKY. It is my understanding that the Farm Credit Administration, as a regulator of the System, has never dictated lending policies to the local associations.

Thus, why should not many of the issues you just discussed more properly be handled by a petition of the member-borrowers to their boards of directors?

Mr. HUMPHREY. I am sure my colleagues would like to have some comment on that, too. My own feeling is that they certainly could be applied through that process. Our problem is, we do not see how we can obtain the consistency, the uniformity of objective standards in these tough times. You know, as the collateral was going up, as things were OK—it is just like as the Senator from Minnesota indicated—when you need that money and you go into the bank and things are OK, you really are not reading all of the materials and the problems do not seem to arise.

But when you are in the more difficult times and things are coming down, obviously you are starting to look at every kind of circumstance.

What we have found is that under those situations, we have an ad hoc nature of the practices. There are some rules and regulations in place.

Some of them are monitored and followed; other places they are not. There does not seem to be a consistent enforcement pattern with regard to the System as a whole, so there is confusion, and that adds to this sense of lack of fairness, that sense of having another day, or perhaps a credit decision, an adverse credit decision that has been made, and you have felt, as the farmer, this was not right.

There is no second chance. There is no opportunity to say what were the standards that were used by them.

Mr. MILLER. Things are not always as they are in theory, or on the chart. The reality sometimes is different in this regard, in two respects, I think. First, while the farmers do theoretically control the System, it is pretty hard for one or two, or even more farmers, to be able to seize control of the whole local unit if they disagree with what is going on.

Second, while local control is an important element of the structure and the theory, in practice, the regional and the national levels do exert a fair amount of control and authority.

Witness the incident in North Dakota. So, it is not always as what appears to be on the chart, the reality, that is.

Senator BOSCHWITZ. I might say that I have always found that there is a certain reluctance on the part of a borrower, at least on my part, to go in and start hassling the lender, particularly when things are getting a little tight. But I know that Sarah wants to say a word.

Ms. **Vogel**. Before joining the attorney general's office I was in private practice, and I can speak from firsthand on the difficulty that farmers have in obtaining money for attorneys.

I was not a high-charging lawyer by any means, and in fact I went broke while I was doing it. Fortunately, my father hired me. The problem is that everything that the farmer has is usually under some kind of security agreement. If there is any kind of Federal moneys involved, whether from Farmers Home, Farm Credit System lenders, or whatever—if you sell that collateral without permission, you have just committed a felony.

If you go into the Farm Credit office and say, "I would like to have $3,000—or $5,000—released to pay a lawyer to help me fight you," you know what the answer is going to be.

You just are not going to have the money. In North Dakota, we have been working very, very hard to try to improve the lack of representation that farmers have.

The attorney general's office has cosponsored legal training seminars. I have gone around and spoken at a lot of farm groups.

Just last week, the attorney general and the president of the State bar wrote a letter to every lawyer in the State, asking them if they would work on farm cases, whether if they needed training material, and whether they would kick in money to a farm fund.

The difficulty is that legal services, the traditional source that representation of indigent farmers should be coming from, just can't handle the need for help. Legal services came late to the rural areas and rural areas have been hardest hit in terms of cutbacks. Legal services in North Dakota has not taken one farm case. They used to refer people to me.

Mr. **Humphrey**. In fact, Mr. Chairman, if I might just add on to that, one of the resolutions of the national association is to look seriously at the criteria allowing legal services in this area, because as Senator Boschwitz' letter, which I am very pleased that he shared with me, indicates right at the beginning that cash-flow is a problem.

And when you attempt to qualify yourself for legal services, you go through an assets test, and as I am sure you are aware, many of our farmers who are in desperate straits, if you look at the assets they are very wealthy people but they do not qualify because they are cash-flow poor.

They do not cash-flow, as they say, and so they do not have the means to obtain those services even though they do not qualify for some of the——

Ms. **Vogel**. They have to sell the farm to save the farm.

Mr. **Hartigan**. I think one of the other concerns is the consolidation and the removal from the local decisionmaking process.

We do have some very good units in our State that do reach out and try and be very helpful. So we are not talking about an all black, or an all white picture, but as the consolidation takes place and the decisionmaking moves further away from the farmer, the need for consistency across the board becomes more and more essential, because then, you lose the interpersonal relationship you had in the past that got you the benefit of the doubt, and that is simply going to exacerbate the situation.

The long and the short of it is, you have got the checkbook, and before the signature goes on the check, these elements of fairness demand it to be built into the system, they will get there. This is the one time it is going to happen.

We can sue. We talked about suing. All 11 of us talked about joint suits, individual suits, and the fact is that in terms of providing real help as quickly as possible, this bill is the place to do it.

By the time we get finished with all of our various law suits, the human tragedies that would be involved simply would not make any sense at all.

Senator BOSCHWITZ. May I ask just a final question. In your testimony, Attorney General Hartigan, you talked about the variable interest rates, and a number of other differences, but would you please, and Skip, and the others, characterize the differences in the relationship between a farmer and the Farm Credit System, and a farmer and a regular bank, the regular lender, I mean. Is it any different. I am sorry I was not here for Sarah's testimony. I read the parts that she says are in that agreement. I think I have signed a number of agreements with banks that practically it took everything except my four sons, and so that those agreements do not seem to be so harsh.

Ms. VOGEL. I have a comment on that.

Senator BOSCHWITZ. The question is, is it different dealing with the Farm Credit System than it is with other lenders?

Ms. VOGEL. Yes; it is. One difference is that when you borrow at a variable rate from a normal commercial lending institution, there is a formula that is going to set at two above the Chemical Bank prime, three above the Federal cost of money, or something like that.

There is going to be a formula. There is going to be something that you can reference to see whether you are being charged the right rate.

The Farm Credit System uses no formula at all. They charge what they want to charge, and I think that one of the bad results of that is that they have had no incentive, whatsoever, for any kind of cost savings.

Anybody who drives around in the Midwest can look at these huge buildings on the outskirts of many of the middle-sized towns. They are the PCA offices and the Federal Land Bank offices.

The other day, for the first time, I walked by the edifice of St. Paul. It is incredible.

Senator BOSCHWITZ. Easy, easy now. But you are right.

Ms. VOGEL. But I think that if——

Senator BOSCHWITZ. That is a true edifice.

Ms. VOGEL. Yes; the farmers need to have a gauge. In in home lending, when there is a variable interest rate, you have a rough idea of what has happened to it in the past or what might influence it in the future.

With a commercial bank you know roughly what Chemical Bank's prime rate is going to be doing. With Farm Credit there is no formula.

I know Congress authorized the use of a variable rate, but I cannot conceive that Congress meant to authorize a variable rate with no formula.

Mr. **Miller**. I think there are some other basic differences, too. No. 1, the farmer owns the System. The farmer has to pay out 10 percent of an operating loan or 5 percent of a land loan into the System as a stock person, so the farmer is the owner.

Second, the System was set up by Congress to aid the farmers over a long period of time, and set up a system whereby they can sell bonds on the market in a very preferential way to help farmers.

Third, we have seen an excessive amount of complaints and abuse from this System relative to commercial banking, so I think it is appropriate to look at it in a different light.

And fourth, they seem to be here for Federal assistance and if they are going to get Federal assistance, I think it is appropriate to put in some conditions to treat farmers in a fair way.

Senator **Boschwitz**. I think we agree.

Mr. **Hartigan**. The more trouble they get in, the tougher they are getting with the people that can least afford it. That is the point we were making earlier about losing 4,000 of these farms.

At the same time the variable rates for the ones in the most trouble are going up with no cap on them. The commercial rates, you know, are dropping.

Senator **Boschwitz**. On the other hand, nobody was complaining when their rates were a good deal lower, and part of the problem, very frankly, is, as you seem to have said in your letter which I have not read, is they went out and hawked their money. They were really competitive, I mean when interest rates were shooting up and they had access to the CIB, and other things.

The **Chairman**. There are bound to be other questions. May I ask each of you, if you would agree, to respond to written questions?

Mr. **Humphrey**. We would very much appreciate the opportunity, Mr. Chairman.

The **Chairman**. Thank you. We have a long list of witnesses. I would like to continue this, but maybe we ought to go ahead. Thank you very much again for appearing.

Senator **Boschwitz**. I thank the Chairman for his indulgence. These witnesses have a more practical, hands on type of experience than most witnesses we get, and that is why——

The **Chairman**. No doubt about it. The Senator is exactly right.

Our next panel is Ky P. Ewing, Jr., of Vinson and Elkins in Washington, DC; Luman Holman, executive director of the Grassroots: National Association of Farm Credit System Stockholders of Jacksonville, TX; and Don Neal, chairman of the Stockholders Advisory Committee, Federal Land Bank Associations of Texas, Rochelle, TX. If you will sit in that order, Mr. Ewing, Mr. Holman, and Mr. Neal. Thank you, gentlemen, for your forebearance.

Let me identify the Senators here, in case you do not know them.

Sitting close to the city limits of Alexandria is the distinguished Senator from Kentucky, Mr. McConnell; the distinguished ranking minority member, Mr. Zorinsky of Nebraska; and Judge Heflin of Alabama.

You may proceed as you wish. I will state, as I always do, if you want to summarize, that your full statement will be printed in the record, so that we may spend more time questioning.

STATEMENT OF KY P. EWING, JR., REPRESENTING GRASSROOTS: NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS AND THE FEDERAL LAND BANK ASSOCIATIONS OF TEXAS' STOCKHOLDERS DEFENSE FUND

Mr. EWING. Thank you, Mr. Chairman. We would like our longer statement to be printed in the record. Please let me summarize our presentation.[1]

I appear on behalf of Grassroots: the National Association of Farm Credit System Stockholders, and the Federal Land Bank Associations of Texas' Stockholders Defense Fund.

You have already introduced Luman Holman, the executive director of Grassroots and Don Neal, the chairman of the Defense Fund.

Grassroots was organized by farmer/rancher borrowers of the Farm Credit System and has representation from PCA's, land banks and cooperatives in 10 of the 12 farm credit districts.

The Defense Fund represents farmer/rancher borrowers from 42 of the 44 land bank associations in Texas.

The aim of these organizations is to try to reflect directly to the Congress, and to the administration, the views of shareholders of the System. They want to help the System stay alive in today's difficulties and to restructure itself to carry out its essential farm credit functions in a more efficient and responsible manner, while preserving the equally essential local control and management of a truly cooperative system.

Mr. Chairman, they believe that this is still possible without an infusion of Federal money at this time, and I would underline the words, at this time.

At the bedrock—if I may put it that way—of shareholder concerns for legislative change are, first: Local control by farmer/rancher borrowers through boards of directors of banks and associations elected by and accountable to each institution's shareholders.

Second, restructuring of the Farm Credit Administration into a true regulatory agency, with the elimination of its loan promotion and management activities and powers, and the elimination of the Governor's ability to appoint 12 of the 84 district directors around the Nation.

Third, returning the System to its essential banking elements, in a way that will restore confidence in the System, both on the part of the capital markets and on the part of the farmer/rancher borrowers.

The shareholder groups are very pleased that a legislative package they helped to prepare, the essential elements of which we believe are necessary to restore confidence in the System on the part of shareholder/borrowers, has been introduced in the Senate as S.

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[1] See p. 389 for the prepared statement of Mr. Ewing.

1790, and we commend the words of Senator Baucus to you this morning in connection with that bill.

We believe, strongly, that the elements contained in that bill are essential if we are to restore shareholder confidence.

There may be other elements that need to be added, and there may be changes needed in details of that bill, but we think the essential elements are there and are required.

We do not ask for Federal assistance from the Treasury or the Federal Reserve Banks at this time, because in our view, the changes that we are proposing are essential preconditions which should be put in place before anyone pours Federal tax dollars into the Farm Credit System.

The 12 main items of the proposal are outlined at pages 5 to 10 of my printed statement. Senator Baucus, in introducing the bill, included in the Congressional Record a detailed section-by-section analysis which further explains the content of that bill.

In essence, at the local level, we want to restore local control by having each bank's directors elected by that institution's shareholders, and by mandating published financial statements using generally accepted accounting principles for all System institutions.

Mr. Chairman, unlike the Farm Credit System's proposal presented to you, and unlike Undersecretary of Agriculture Frank Naylor's proposal of yesterday, we would eliminate the Federal regulator appointing the seventh member of each bank's board. There are 12 district boards around the country. The regulator, right now, is appointing 12 out of the 84 directors that actually are the legal entities controlling this System.

That has to be addressed by the Congress if you are going to make any regulator an arm's length regulator. You will have to come to grips with the question of how to restructure the boards of directors of the Federal Farm Credit districts.

We believe you should use the proposal we have made in answer to that, and thus restore greater local control.

At the national level, we propose a true regulatory insurance agency on the FDIC model, with real cease and desist powers to stop unsafe and unsound agricultural banking practices, and with an insurance fund which it will be required to use to insure against illiquidity, or impairment of capital in System institutions, after they have used their own reserves to help themselves.

We propose that the President appoint the three member board of directors with the advice and consent of the Senate. If for any reason the administration objects to having the President appoint the Federal Farm Credit Insurance board of directors, the Congress might have the Chairman of the Federal Reserve Board appoint the members of the board of directors of the FFCIC, as we call it.

What we want are neutral members, acting in accordance with principles that have been specified, and which they are obliged to use to help the institutions of the System.

Our proposed Federal Farm Credit Insurance Corporation would have, under the way we have structured it, every incentive to stop the current wave of liquidations, and forced mergers, because its responsibility would be to work out each system institution's local problems, on a workout basis rather than a liquidation basis.

The FFCIC's fund, in our proposal, would be created by an initial transfer from current system institution reserves at the lowest figure Congress determines to be required.

S. 1790 has in it a transfer of 3 percent of the loan portfolios of the primary lending institutions. That would produce an immediate reserve of about $2.3 billion.

I might and to you, that would give you a ratio of 3 percent. By way of comparison, the FDIC has a ratio of fund assets to insured deposits of about 1.23, and at the worst of the Depression it was up to a ratio of about 2.0. So we are creating a slightly larger fund, compared to what we are having it protect, than is true for the FDIC, but it is roughly in the same ballpark.

Unlike the Farm Credit System Capital Corporation that was proposed to you by the System's spokesman and that Undersecretary Naylor has also proposed to you, our FFCIC would operate on a true FDIC insurance agency principle, would have a responsibility on fixed standards to keep System banks and associations afloat in principled ways, and would be run by neutral officials.

It would not represent, as the Capital Corporation proposal does, the unprincipled commingling of funds, with no obligation to repay, or even report, to the individual System banks, how they are being used.

Ours is quite different from the Capital Corporation proposed by the System's spokesmen.

In our FFCIC proposal, the funds that we would transfer to produce the fund would, of course, earn interest. To the extent possible, the interest earned by the fund would be rebated to the individual System banks and institutions, in order to help them lower the interest rates to farmers, provided those earnings are not needed to carry out the essential parts of the fund's responsibilities.

Mr. Chairman, having in our proposal returned management power back to the shareholders of the System, and to the directors of the System's own institutions, and having created a true regulator-insurer on the FDIC model, we would propose the sunset of the Farm Credit Administration, and of the nonbanking corporations they have recently spawned as service entities.

In addition to these structural changes, we propose two other tools to help the System. First, we propose authority temporarily to lower the System's capital requirements now set at 10 percent, to a level of not less than one-half of 1 percent above commercial bank capital requirements, which currently have a ratio of primary capital to total assets of 5.5 percent.

Finally, as a last tool to be added, we propose that the local primary lending institutions be given lease-back authority designed to let local decisions permit an alternative to foreclosure and sale of collateral.

Where viable farming operations can continue to be conducted, that will produce future streams of income at current commodity prices sufficient to service the debt, we should not have to put the land onto an already oversaturated market, and thus drive the prices of farm land even lower. Our proposal builds in some checks and balances on the PCA's and the land bank's use of this lease-back authority, by permitting the FFCIC to make special rules, and to charge higher premiums for assets leased out. Our proposal here again is quite different from a national corporation warehousing approach being urged on the Senate and the House by others.

Before closing, let me make four fairly brief comments: First, there does seem to be a consensus that legislative changes must be promptly enacted.

Second, we believe that merely throwing more authority to the present Federal regulator, plus pouring in $5 billion in taxpayer money, as Governor Wilkinson has now asked for, is simply not enough to restore borrower confidence in the System, and unless you have that borrower confidence, this System is going to collapse in on itself as good borrowers leave.

Third, allowing the 100 men that presently describe themselves as "the System"—namely, the 84 directors, the 14 bank presidents, and the presidents of the Funding Corporation and the Farm Credit Council—to aggregate further power to themselves in order to move the System toward a central entity bank holding company operating in 50 States, plus giving them the $6 billion of taxpayer money they want, with no strings attached, will also not restore borrower confidence in this System.

To the contrary, that kind of approach will further alienate borrowers who, as the Congress is aware, and as you have certainly heard this morning from attorneys general for many of the States, are all up in arms against what they perceive to be abuses by those currently running the System.

I want to point out to you in particular that the System's Capital Corporation, which is the bedrock of their proposed solution to this, consists of a board of directors which itself is simply the 14 bank presidents. Those who ostensibly are the employees of the System would be converted into the central board of directors of the National Corporation that would be controlling the $75 billion Farm Credit System.

That moves 180 degrees away, Mr. Chairman, from shareholder/borrower ownership and control and accountability of the Farm Credit System.

We believe, finally, that Federal money simply should not be made available until first, the System has demonstrated that it is using its own assets, and using them through an independent FFCIC type mechanism in a principled way, and, second, until structural changes have been made to ensure shareholder rights to local control and decent treatment, so that future funds are prudently employed and employed to the benefit of American agriculture.

We respectfully ask this committee to give serious considerations to the principles embodied in S. 1790. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much. Mr. Holman, do you have a statement?

STATEMENT OF LUMAN HOLMAN, EXECUTIVE DIRECTOR, GRASS-ROOTS: NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS, JACKSONVILLE, TX

Mr. HOLMAN. Mr. Chairman, and gentlemen, let me also thank you for this privilege of saying a word on behalf of stockholders from the Atlantic to the Pacific, from the north boundary to our southern boundary, even to the isles of the Pacific and Hawaii, in behalf of just one thing, and that is the right to rule our own destiny.

As it stands, we are the only corporation in these United States of America, wherein the stockholders do not elect the directors who are to manage their business.

So we are simply here in behalf of freedom, to ask for those people who have been through the years, fortunate enough to have accumulated several billions of dollars in capital, whose authority has been eroded and taken recently away from them, to again, have the privilege, and also, the responsibility, of maintaining their own destiny.

So, on behalf of those gentlemen, as well as myself, we are simply here to ask for you to provide for us, that which every other corporation in the United States has.

This is the purpose for us being here. If you will recall, in the 1971 act, the Congress, in its wisdom at that time, simply said that local people who knew local conditions would make decisions based on that.

This has been very prudent through the years, and has enabled this institution to have accomplished more than any of the institutions with which we are familiar, throughout the length and breadth, not only of our country, but the world itself.

And we submit to you, the proof of the pudding is in the eating, and our record is one of unparalleled success and unprecedented success, until the recent years, when this authority has been eroded and has been taken away from us.

We are not here for a handout. We believe we have the assets to care for our own situation. We simply again ask you gentlemen to provide for us this freedom which we seek.

In conclusion, let me simply say to you, gentlemen, that that man is no fool who gives that which he cannot keep, to gain that which he will never lose.

Our plea is for freedom. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, sir. You said recent years. If you were asked to pinpoint when the erosion really became dangerous, when was that?

Mr. HOLMAN. When it became dangerous was with the ascent to authority of Mr. Wilkinson.

The CHAIRMAN. What time frame?

Mr. HOLMAN. He said yesterday about 9 years. So, within the last 9 or 10 years. By the infusion of these various boards with selected people in each of the districts. Four people, as a minimum, can control the destiny in my own State of 50,000 people who have consistently voted against this type of an operation. But four people who are subjugated to the whims of this authority have been outvoted, and our wishes have been completely denied and whereas we were told we would operate cheaper and more efficiently, the facts of the matter, after a year of this type of management, our costs are greater and our efficiency is far less. And our people have been subjugated to all types of coercive power.

The CHAIRMAN. Mr. Neal, do you have——

Mr. NEAL. I would hate to miss the opportunity.

The CHAIRMAN. Go right ahead.

STATEMENT OF DON NEAL, CHAIRMAN, STOCKHOLDERS ADVISORY COMMITTEE, FEDERAL LAND BANK ASSOCIATION OF TEXAS, ROCHELLE, TX

Mr. NEAL. I appreciate very much being here also. It's still the United States when a mullet like myself can reach this state. I appreciate that.

I would like to say to you that I represent the land bank associations in Texas. What those people chose to do was to say that this has gone far enough without an explanation. If there is to be an explanation, someone has to say, let's stop and let's take whatever it costs, and let's take the time and let's go back to the beginning and see who owns this System.

It's our understanding and our belief after studying it that this System was bought and paid for by the borrowers and that those borrowers are farmers and ranchers that live out in the country.

It also is our understanding that the stock that goes with each loan belongs to that farmer, and that it is at risk, and that that borrower has the opportunity of losing that stock.

If these two facts are true, as we think they are, then we think that we should have a considerable amount to say about how this System is run, and who this System should serve.

So, we proceeded on that particular line of thought, and we were much surprised to find that while many of us were guilty of resting on our laurels and having a System that for some 50 years had functioned in a great fashion, and assets begin to build up and everybody's happy, so nobody really paid a lot of attention.

All of a sudden, times got rough, and our System got tested. At that point, we found out that we have some failures in our System, and we have given away a lot of the rights in our System that we shouldn't have given away.

I would like to limit my remarks to a few key things that I think you people probably heard yesterday, and a few things you heard today, and I am speaking to you strictly as a grassroots borrower. I'm a—I don't want to go into the offices. Just, all I can tell you is I'm a borrower from the land bank and a borrower from the PCA which I paid down to $1 the other day because I still want a voice over there but I'm a little concerned about the way they handle their stock.

I'm concerned about mergers, and I'm particularly concerned about liquidations. There is in my opinion no written rules within the Farm Credit Administration as to how the liquidations are supposed to take place. I think Farm Credit has stepped over the line—the Farm Credit Administration—has stepped over the line in some liquidations they have already done.

I am not an attorney like the previous group, and I would not want to get into the legal aspects of that. But they do have the power to go in and to make a determination and examination much the same as the FDIC. When they make this examination, they can arbitrarily write down loans, that maybe the people who are there know that those loans are good. They do not have to necessarily consider all the aspects of the repayment of that loan to write it down. They can put an association into a position where it can be liquidated.

Then you notice that they have used a lot of force to force mergers in a lot of places, and before I go any further, let me say that I do not oppose mergers. I oppose mergers forced by the district level or the Federal level. I do not in any form, I applaud stockholders coming together and deciding that they can merge on their own and be of an advantage to the stockholders. That's the right we're asking for.

And if we can come together and do it, but not under any form of pressure from above that if you don't—this I don't agree with. This is part of the reason I'm here.

But Farm Credit has said that we must merge because this is more efficient, and you will merge. And the liquidations have had some part to play with that.

To digress a little further over, let's go back to the Federal Farm Credit Capital Corporation. In my opinion, if you will read Project 1995, and if you will read, the final phase three of Project 1995, you will see where the Farm Credit Administration, or the Farm Credit System is setting up nothing more than another one bank holding company. It's not a one bank, but a bank holding company, just another big holding company. We already have plenty of those out at home that we can talk to and borrow from if we need to. This one was never intended to be a bank holding company.

This—they had so much opposition to that that they said no, we won't take the central entity thing. This Federal Farm Credit Capital Corporation, directorship of which would be the bank presidents, is nothing more than central entity under a new name. There is a better way than that.

I would prefer our Federal Farm Credit Insurance Corporation in that it details how the money would be taken. It details how the money could be repaid, and it takes the position of an insurance-type regulator and controller of these funds.

As to the bailout aspect which I know that you have heard quite a bit about. I would say that this is hard to say. Because I come from one of the districts that has been more fortunate, and we have ample reserves in our district.

As of right now, the land bank interest rate in the district in Texas, the Tenth Farm Credit District, is at 11½ percent, and it would be at 11 percent, but we can't get the approval from the Farm Credit Administration to do so.

It will be there because we have a lot of legal reserves and surplus in our System. We have been more fortunate than some of the other areas. Just plain lucky. We haven't had the land price drop and several other things that they have had. But on the other hand, we've been prudent, and I would point out to you that during this time, the Farm Credit Administration has been present in our district, telling our district boards that the land bank in Texas is far too conservative. You must become, you must step in and take a bigger percent of these loans. You've got to get more loans.

They called us the Texas Mafia down there, and down in my own association, the compensation plan from the bank level was changed to where the compensation to the associations mainly was based on new volume, new loan dollars. The salaries of the presidents of those associations were based on how well they carried that out.

Now, that's the truth. I can get you depositions of former district directors that will tell you that, and I can tell you how it worked in those associations, because we told them we represent the stockholders, and they elected us to be directors of these associations, and we may be too conservative, but we're making money, and we're making most of the loans that aren't carried by the individual selling the property. We think we're doing our job.

When times got tougher last year, all the associations down there went together, and went to the bank. This was in 1984, and said we'll forgo our compensation. And leave it for the bank so the bank can make money on those assets and keep the interest rate down to our borrowers.

What that did, there were 12 associations in our district that didn't make any money. I would like to tell you that ours made $150,000. We don't have a fancy building. We've got a building we renovated. We don't have any automobiles in our building; they drive their own automobiles at our place.

You stay with those kinds of principles, it will work. Part of their problem is that they didn't stay with those.

I'll get away from that. Texas hates to give up their money. But, gentlemen, we made the money, we agreed in 1971 that we were jointly liable, and I suggest to you that we go ahead and use the funds that are in the System before we put in any more funds. Because that's what they were made for, that's what they were set aside for, and that is proper. I do not think we ought to drain all of them out, because that will weaken the stronger districts to too low of a level and we will be in a problem.

After that, there should be a mechanism in place, and the Government, I believe, should step in at that time and put in Government funds.

I'll get through with this. If you would help to stabilize the costs of our funds, which you can do by guaranteeing our funds in the market, if you would ask us to make use of our unallocated surpluses and use them in the right way.

The third thing is to have some standby help from the Government. This System can't fall. There is no other place to get this much long-term credit as there is in the land bank. I'm sorry. I'll shut up.

The CHAIRMAN. What are you sorry about?

Mr. NEAL. I always talk too long, Senator.

The CHAIRMAN. That's all right. A U.S. Senator would be the last one to say anything about that.

Mr. NEAL. Thank you.

The CHAIRMAN. Well, thank you.

Senator Heflin had to leave, and he left six questions with me, five of which he would like to submit to you in for written answers (see p. 122). One he asked me to make a part of the record on this day, it being: Both the shareholder organizations you represent, and the spokesmen for the System, seem to support use of existing System assets through a kind of central fund. Is there any real difference between your proposed Federal Farm Credit Insurance Corporation and their Farm Credit Capital Corporation?

Mr. EWING. Senator, first, we would be more than happy to answer all of the questions in writing. Second, let me try to address the question you have posed.

There are immense differences between taking the earned surplus reserves of all parts of this System and giving them to the Farm Credit Capital Corporation, as opposed to taking a portion of the reserves of this System and putting them into a Federal Farm Credit Insurance Corporation.

First, a Farm Credit Insurance Corporation, as we've proposed it, would be run by neutral people not now a part of the group of 100 that constitute, in their own words, "the System."

Second, it would perform a true insurance-type function, as the FDIC performs it.

In contrast, the Capital Corporation that the System already has in place itself has a board of directors consisting of the 14 bank presidents, the men who should be the employees of the shareholders.

The proposal of the System is to take the earned surpluses of all System institutions away from even the Farm Credit directors that the shareholders do have a right to elect, and give them to the 14 bank presidents, with no standards of repayment and no provisions of repayment, whatever. The System's proposal has no standards for use of the earned surpluses, and no requirement or mandate for the use of those reserves to avoid liquidations, and avoid losses of shareholder B stock around this country. Rather, it would simply be the giving to the 14 bank presidents what their Project 1995 proposed, which was a super, national bank holding company, their "central entity" as they've described it for years, which would have 50 State subsidiaries, and a lot of local branch windows at which you're supposed to have one-stop agricultural banking.

Well, if you are an employee, it's nice if the employees of the System get into their hands all of the earned surpluses of the System. I suppose some of us might like to be on the short list for the CEO of such an institution—and that's not a joke. You might want to ask some of the other national farm organizations about this, because they've been asked to supply a short list of names for a CEO that the System proposes to pay $450,000 to $500,000 a year to run this central bank.

The differences, Mr. Chairman, are immense between the System's Capital Corporation and our FFCIC. We believe we have proposed in our Federal Farm Credit Insurance Corporation something truly akin to the FDIC which the Congress in the middle of the Depression put in place in order to help ensure the continued existence of independent banks, so that we wouldn't suddenly have a mass set of mergers that left us with three or four huge banks in this country.

To maintain the local control over lending that is represented by the existing individual banking entities of the System, and to provide strength for them through an insurance mechanism, is what we would like to see applied to the Farm Credit System. And the contrast between our proposal and that of the System couldn't be greater.

The CHAIRMAN. My wife says that the older I get the more anecdotal I get. But I was sitting here thinking, while you folks were testifying, and the previous panel for that matter. Several years ago--I hadn't been in the Senate long—I saw in Raleigh at a meeting one of the wisest bankers I ever knew. He's deceased now. His name was C. Lacey Tate. He was president and chairman of the board of a country bank then—it's now part of a larger chain—but a country bank then known as Wakama Bank and Trust Co. in Whiteville, NC.

He was complaining about exactly what you three men were testifying about this morning. He said, Jesse, I don't know what you can do about it because it's kind of a dictatorship. He was a blunt man.

But he said they are not acting prudently. He went on to say that they were involved, intentionally or otherwise, in a process of encouraging the escalation of investment in land. He said it's already out of hand in terms of what the land is really worth.

He said I won't live long enough, probably, to see it, but you've got a disaster on your hands lying down the road.

All of us have what I call elder statesmen of banking or whatever, but I was sitting here this morning thinking how prophetic Mr. Tate was.

I was also engaging in a bit of personal remorse, because I did nothing more than write two or three letters which are in my file somewhere inquiring about this, and being a new Senator, I guess I let it go. Because I got letters back saying everything's hunky dory. Well, you know, you look back at the mistakes you made, and maybe I should have just gotten on a steed, and ridden forward with my lance in hand. But I don't know that that would have done any good. Because everybody was riding that boom up the hill, you know, and now they are on the top and are about to fall off the cliff.

Do you have any questions, Senator Boschwitz?

Senator **Boschwitz**. No, I don't. I found it very interesting. I find it interesting that the Texas bank is so agreeable to sharing its capital. I think it's one of the banks that's in better shape, and as I recall, the amount of difficult loans was smallest at your bank of any system although maybe the Springfield bank was smaller. But I found it very interesting. I think that in the event we give any aid to the land bank and the PCA's and the cooperatives that clearly we will make some changes.

We didn't hear these kinds of things—of course, I wasn't here at the time—but I presume that nobody was complaining when rates were low, and they really were hawking the money. I hadn't known before these hearings—these hearings always serve a purpose of education—that their compensation rates related to how much they loaned out. I would have made a lot of money under those circumstances, I want to tell you. But it's very interesting testimony, Mr. Chairman.

Mr. **Neal**. I just want to say that wasn't the Texas banks that said they would give away that money. That was me. I don't represent the Texas banks. I do represent the Texas Federal Land Bank Associations, and I think they'll stand with what I said.

But I'm not on a district board, and am certainly not speaking for the Texas banks.

I just feel that in 1971 they tied us together, and I just feel that you people up here on the Hill have got your hands double full of handouts and money problems, just paying your own debts, and we're going to have to use our reserves before you're going to help us. That's what I think.

Senator BOSCHWITZ. Mr. Ewing, you said the same thing.

Mr. EWING. Yes, sir.

Senator BOSCHWTIZ. That the Texas banks will share.

Mr. NEAL. He's just representing us.

Senator BOSCHWITZ. I understand.

Mr. EWING. Our proposal, Senator, certainly does have that absolutely written in it, and the details of it are in the Congressional Record.

Senator BOSCHWITZ. So Mr. Neal is right that certainly all investors in those securities in the Farm Credit System always expected that there's an interrelationship, and that interrelationship is certainly not as clearly and as accurately and as carefully defined as it should be. I'm aware that some of the banks are dissipating some of their assets, so that they won't have to come up with giving away any of their monies to Omaha, or Spokane, which are in difficulty.

Thank you, Mr. Chairman.

The CHAIRMAN. One final comment. When I went over to vote a while ago a reporter covering this hearing asked me in effect how much money the administration was going to support for this problem.

I don't know whether it was he or I who referred to it as a bailout. Maybe both of us did. But my answer to him is that I didn't know and I don't speak for the administration, but I do know that the administration wants to have a restructuring of this thing to assure integrity and prudence and so forth prevail.

Now, after we get that information, and after we see where we are, then we can look at the figures. But for too long around this place—and I submit when they talk about Reagan's deficits, they don't know what the Constitution says. As far as I know it hasn't been changed, and that no President, Reagan or Carter, or anybody else can appropriate one thin dime.

So, I think first of all we ought to call it the Congress' deficit. Second, we certainly should stop this business of trying to solve all of the problems of mankind by throwing money at it.

Thank you very much, gentlemen. It's a pleasure to have you, and it's good to see you again, sir. I want you to come back to Raleigh sometime and spend some money. Give Howard Baker my regards.

[Written questions from Senator Heflin and Mr. Ewing's answers thereto follow:]

VINSON & ELKINS, ATTORNEYS AT LAW,
Washington, DC, November 20, 1985.

Re: Farm Credit System Legislation.

Senator JESSE HELMS,
Chairman, Senate Committee on Agriculture, Nutrition, and Forestry, Russell Senate Office Building, Washington, DC.

DEAR MR. CHAIRMAN: At the Senate Agriculture Committee hearing on November 1, 1985, you asked that we respond to a series of written questions posed by Senator

Howell T. Heflin in connection with our support for S. 1790. We are pleased to have the opportunity to respond as follows on behalf of Grassroots: The National Organization of Farm Credit System Stockholders, and on behalf of the Federal Land Bank Associations of Texas Stockholders' Defense Fund:

Question 1. Your group, the FCA, and the spokesmen for the System, all support a federal regulator with real power. Are you satisfied with the language on this proposal by FCA?

Answer. While we appalaud those parts of the FCA's legislative proposal which would move the FCA away from being the System's business manager and toward a role as arms-length regulator, we are not satisfied with the FCA proposal, which has serious flaws. S. 1790's provisions for an arms-length regulator are far preferable to those proposed by FCA.

On the very important issue of local control, the FCA proposal retains the FCA's appointment power over the seventh member of each Farm Credit District Board, which is hardly an arms-length regulator's job, and which directly puts the regulator into the management of the banks. This is especially bad, because the FCA proposal maintains the present fiction that a district board can act as a true board of directors representing the shareholders of each bank in its district even though that bank's shareholders elect only two of the seven directors. This point is more fully covered in answer to Question 4.

Although FCA's proposal appears to deregulate some of the internal affairs of banks and associations, the FCA would retain regulatory authority over system interest rates charged by banks and associations, would exercise almost plenary authority over the charters and by-laws of System institutions and their classes of stock, and would even have to approve the establishment of bank branch offices and the provision by banks and associations of technical assistance to borrowers.

Another point concerning local control, moreover, is that the FCA proposal retains for the FCA its present, extensive power to force the mergers of institutions and territories. This is also not the job of an arms-length regulator and serves only to undermine the confidence of System borrowers in their institutions.

The FCA proposal also does not require the newly empowered FCA to bring "sunshine" into the practices of System institutions. Accounting and financial reporting are still to be generated by System institutions internally, instead of being done by outside certified public accountants under generally accepted accounting principles, as the Shareholder Proposal (S. 1790) would require.

Lastly, the FCA proposal defines "unsafe and unsound practice", which is a major trigger for its enforcement authority, as a matter of "opinion" on the part of the FCA. No other federal agency involved in bank regulation has such unbounded discretion, and we fear that this would allow such a newly empowered FCA to be as interventionist in the future as it now is. We urge that Congress be very careful that any changes made to the present system of federal regulation not be merely cosmetic, and not add to the shareholder-borrower lack of confidence in the System.

Question 2. Both the shareholder organizations you represent and the spokesmen for the System seem to support use of existing System assets through a kind of central fund. Is there any real difference between your proposed Federal Farm Credit Insurance Corporation ["FFCIC"] and their Farm Credit Capital Corporation?

Answer. The differences are immense, as was explained orally at the hearing on November 1, 1985.

The Shareholder Legislative Proposal (S. 1790) calls for an FDIC-type neutral insurance fund, run by neutral professionals in accordance with Congressionally mandated principles for the use of the fund to keep the individual banks and associations functioning on a decentralized basis throughout the country.

In contrast, the Farm Credit System's proposal is to use their existing national Farm Credit Capital Corporation, the board of directors of which consists of the 14 bank presidents, as the manager of the commingled surpluses of the System's separate institutions, with no repayment provisions, no standards to govern use of the monies, and no mandated responsibility to keep System banks and associations functioning in a decentralized cooperative system. Mr. Douglas Sims, the Farm Credit Council spokesman for "the System", described his view of the Capital Corporation as follows:

> "The Capital Corporation's proposed new role makes it, for the foreseeable future, *the most powerful* institution in the Farm Credit System, because of its broad powers over most System operations." (Emphasis added.) [1]

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[1] Testimony of Douglas D. Sims at the November 21, 1985 hearings before the House Agriculture Subcommittee on Conservation Credit and Rural Development.

Attached to this letter, and made a part hereof, is a two-page analysis of the System's own Capital Corporation proposal, demonstrating that it would in fact be the creation of the "central entity superbank" that some of the System's leadership have long sought as part of their "Project 1995" (Attachment 1). The shareholder-borrowers of the System oppose that kind of "central entity."

Question 3. The Shareholder Legislative Proposal (S. 1790) suggests lease-back authority to keep land off a saturated market and keep farmers on the farm. How does this differ from the warehousing authority for defaulted loans that the System's spokesmen propose?

Answer. The major difference between the Farm Credit System's warehousing authority for defaulted loans and the Shareholder Legislative Proposal (S. 1790) is that the Shareholder Proposal would leave the management and operation of the lease-backs in the hands of the Production Credit Associations and the Federal Land Bank Associations (acting for the Federal Land Banks), rather than creating a national corporation to try to make the myriad judgments that would need to be made about whether viable local farming operations could be continued under lease-backs. Even Mr. Swackhammer, spokesman for the Farm Credit System at the House Agriculture Forum on November 6, 1985, admitted that the System's national warehousing corporation (the already existing Farm Credit Capital Corporation) would need to hire the local associations to perform the management of the lease-back program. If that is true, there is simply no need to have land titles being centralized in a national corporation, with all that that adversely connotes to the farmers and ranchers of this nation.

The Shareholder Legislative Proposal (S. 1790) adequately addresses the need for national standards to govern the lease-back operations by local associations, by permitting the arms-length regulator/insurer (our proposed FFCIC) to promulgate special rules about leased-back assets and to charge higher premiums for such assets covered under the insurance fund.

The stark difference is between the System's proposed centralization of power in a national warehousing corporation, as contrasted with S. 1790's local management and control of the lease-back program.

Question 4. Why are separate boards of directors at the bank level so important to shareholder-borrowers? Don't the farmer-rancher borrowers already elect directors of their PCA's and Land Bank Associations?

Answer. Farmer rancher borrowers today directly elect separate boards of directors to run the association—the Federal Land Bank Associations, the Production Credit Associations, and the Cooperatives. The association-level directors in turn elect the directors of the Farm Credit District Boards, of which there are 12, one for each of the farm credit districts.

It is at the District Board level that improper corporate governance principles are employed in the current law. Each seven-member Farm Credit District Board is now "deemed" to be the legal board of directors for three separate banks in the district, namely, the Federal Land Bank, the Federal Intermediate Credit Bank and the Bank for Cooperatives. On each Farm Credit District Board, two of the directors are elected by the Federal Land Bank Associations, two directors are elected by the Production Credit Associations, and two are elected by the Cooperatives, while the seventh board member is appointed by the Governor of the Farm Credit Administration. Thus, when such a board is "deemed" to be acting as the board of directors of the Federal Intermediate Credit Bank, for example, only two of the seven board members have to stand election by the Production Credit Associations that are the shareholders of that bank and whose association-level officers have themselves been elected by the farmers and ranchers in the PCA. The same is true, of course, when a seven-member Farm Credit District Board is "deemed" to be acting as the board of the Federal Land Bank, for only 2/7ths of its members have to stand election by those responsible to the farmer/rancher borrowers from the Land Bank.

The shareholder-borrowers believe that this has led to a lack of discipline on the part of the Farm Credit District Boards, when acting as the legal governors of each bank. It has certainly resulted in grave lack of confidence on the part of shareholder-borrowers from a given bank within the System that their assets (and the risks associated with their shares) are being truly managed in their interest, because the board members are not accountable to them at the ballot box.

An example of this lack of sensitivity to shareholder concerns by District Boards as presently constituted is evidenced by the actions in Texas on November 19, and 20, 1985. On November 19, 1985, the Farm Credit District Stockholders Advisory meeting of the FLBA's, the PCA's, the OFI's, and Cooperatives, along with members of the Texas Farm Credit District Board, was held to hammer out legislative comments on a draft of H.R. 3792, in a session of give-and-take and compromise on everyone's part. An agreed list of nine suggestions was adopted. The next day, on November 20, 1985, the District Board met alone, and adopted a very different and shortened list of only 5 items—leaving out such agreed comments as "establish separate district boards as proposed in Senate 1790." Both the original agreed list of nine items, and the different and shortened list of five items, are attached hereto, so that Members of Congress can see for themsevles why shareholder confidence has eroded in the District Boards as presently constituted, and why it is so necessary to adopt corporate governance reforms that will make those who govern bank assets stand election before each bank's own shareholders. (Attachments 2 and 3).

If Congress is to make the Farm Credit System work more effectively, it certainly must also eliminate the power of any regulator to appoint a member of the governing board of a regulated bank. Such appointment power is totally inconsistent with arms-length regulation.

If the Congress in its structural reforms is to impose real discipline, it should do so by making all members of each bank board stand election before that bank's own shareholders. S. 1790 accomplishes this in a direct and efficient manner. Unless this is done, shareholder-borrower confidence in the management of the banking institutions of this System will not be restored and the political unrest and unhappiness will continue. The State Attorneys General, on November 1, 1985 before the Senate Agriculture Committee, gave eloquent testimony of the unrest on the part of shareholder-borrowers. Restoration by Congress of proper corporate governance principles would be a fundamental step toward solving this problem, by making it clear that this continues to be a federally chartered cooperative system of de-centralized banking institutions, locally managed and locally controlled.

Question 5. The FCA says Congress should use $5 billion of taxpayer money to help the Farm Credit System. The System's spokesmen ask for $6 billion. And you say that Congress shouldn't use federal money at this time. As farmer-rancher borrowers, aren't you interested in federal help? How do you reconcile your position on federal assistance with that of the spokesman for the System?

Answer. The shareholder-borrowers of the System recognize that federal assistance may ultimately be necessary, particularly if the overall farm economy worsens or if the world economic situation takes a downturn. But the shareholder-borrowers also believe that the Farm Credit System continues to have significant strength in its reserves, and in its record of achievement. If structural reforms are put in place so that the System's own resources can be more effectively brought to bear as self-help measures, the amount of federal assistance can be minimized and the timing of federal assistance can perhaps be postponed.

What is needed is structural reform, by way of the creation of an FDIC insurance type fund, to be managed by neutral officials, with a responsibility mandated by Congress to keep the System institutions running, rather than forcing their liquidation. What is also needed are corporate governance reforms that will supply discipline to the boards responsible for managing the banks in a prudent manner in the future.

We wish to emphasize that these structural reforms, including corporate governance reforms, are needed both (1) to enable the System's own financial strengths to be used most effectively in self-help, and (2) to reestablish shareholder-borrower confidence in the System, without which the System will collapse into itself because of the flight of good borrowers. Legislation making the structural and corporate governance reforms contained in S. 1790 will not only reassure the capital markets, but also reassure the equally important shareholder-borrowers.

The System's spokesmen want federal assistance with as little change or inconvenience to their accustomed ways of dealing as possible. The Treasury Department presumably wants to spend nothing, or at least as little as it can. Attached is an analysis of "Potential Existing Sources of Assistance to the Farm Credit System" that could provide temporary or partial help. (Attachment 4).

While the System posits a worst case scenario of about $6 billion of defaulted loans (face value) by the end of 1986 (which would net out after sale of collateral to considerably less than $6 billion in actual losses), the shareholder-borrowers (and the Treasury Department) not that as of September 30, 1985, the System (combined 37 banks and associations) had $1.6 billion in loan-loss reserves, earned surpluses of $5.1 billion, and capital stock of $6.1 billion.[2] Of that, $5.3 billion was held in liquid and cash instruments.[3] Even on the System's worst case scenario, substantial self-

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[2] Source: Farm Credit System Press Releases of November 6, 1985.

[3] Note is made that the Federal Farm Credit Banks Funding Corporation's October 23, 1985 release of financial statements as of September 30, 1985 showed that the total risk funds for the

Continued

help is clearly possible, particularly if Congress enacts the structural and corporate governance reforms of S. 1790 that will, in turn, restore the confidence of the capital markets and of the shareholder-borrowers, thus allowing the continuing functioning of the Farm Credit System institutions as banking institutions that can utilize shareholder equity to obtain capital market funds.

It is important that no actual re-transfer of funds to various localities within the System be done in a fashion that causes interest rates to borrowers in any area to increase more than very marginally, if the flight of good borrowers from the System is to be avoided.

It is also critically important that the investor confidence in the System be buttressed by swift legislative action this winter on System reforms which will allow discretionary Treasury authority to provide financial assistance to the System to become operative as soon as possible.

Question 6. You keep emphasizing shareholder-borrower confidence. Won't the borrowers' confidence in the System return if federal assistance is provided?

Answer. If federal assistance is provided without any of the structural and corporate governance reforms proposed in S. 1790, we do not believe that shareholder-borrower confidence will be restored. The flight of good, solid, viable borrowers form the System, which is already starting to take place, is based in part on the fear of forced liquidation (and consequent loss of the stock in which a borrower from the System must invest, in order to be a borrower), and in part on the higher interest rates that are now being occasioned by failure of those currently in charge of the System's institutions to manage in a more effective manner (which our proposed structural reforms would allow and require them to do).

Even if federal money is utilized in the System, the flight of borrowers out of the System must be addressed. In our view, only corporate governance reforms and structural reforms can accomplish this, and do so in ways that will ensure prudent use of any federal money that is eventually employed.

We very much appreciate this opportunity to answer the questions posed by Senator Heflin, and stand ready to assist the Committee in way we can during its consideration of the important issues involved in Farm Credit System legislation.

Sincerely yours,

KY P. EWING, Jr.

Attachments.

[Attachment 1]

ANALYSIS OF FARM CREDIT SYSTEM'S PROPOSED "FARM CREDIT SYSTEM SELF-HELP AND FEDERAL ASSISTANCE ACT OF 1985"

The Farm Credit Council, on behalf of the Farm Credit System, has proposed a bill that would grant $6 billion in federal assistance to the already existing Farm Credit System Capital Corporation ("Capital Corporation"). The bill would give the Capital Corporation almost plenary power to administer the federal money within the System.

The bill also grants the Capital Corporation significant new powers, in addition to those it already possesses in its Articles of Incorporation and By-Laws, to function as the "super-bank" of the System.

The Capital Corporation's board of directors consists of the "members of the Farm Credit System Finance Subcommittee" (Article IV of the Articles of Incorporation) which by virtue of Section 4.25 of the Farm Credit Act of 1971, consists of the 14 presidents of the system's 37 banks. They, of course, can appoint a Chief Executive Officer.

Under its existing Articles of Incorporation, the Capital Corporation has power "to exercise all authorities and powers of the Banks under the Act consistent with the purposes of the Corporation." (Article IV, Section 24).

The Farm Credit Council's new bill would have Congress ratify the existing powers of the Capital Corporation and add the following powers, among many others:

To "assess System institutions" (Section 4.25A(a)(1))

To borrow from any lending institution (Section 4.25A(a)(3))

To "issue its own notes, debentures, or similar obligations" (Section 4.25A(a)(5))

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37 Farm Credit Banks alone (not combined with associations) was $9.6 billion (consistig of $4.9 billion of capital stock, $3.6 billion surplus and the $1.1 billion allowance for loan losses), with "investment securities and cash" of $5.3 billion.

To "join with System banks in issuance of System-wide notes, bonds, . . ." (Section 4.25A(a)(6))

To "supervise to the extent it deems appropriate, local administration, servicing, and restructing of loan and loan-related assets . . ." (Section 4.25A(a)(4))

To "loan money to any person who is a borrower of any System institution and whose loan has been sold to . . . or participated in by, the Capital Corporation" (Section 4.25A(a)(7))

With these powers, the CEO of the Capital Corporation would, in effect, be in charge of a super-bank, the very purpose of which is to allow commingling and redeployment of the earned surpluses of the 37 banks within the System, and to use the requested $6 billion of federal money.

No standards are specified by which the commingled funds (and the federal money) are to be used, either for the benefit of the 37 banks or for the benefit of the farmers who borrow from them.

With this added authority, which would continue beyond the present crisis situation (and which is not limited to a time when federal assistance is outstanding), the 14 Bank presidents would have created what their "Project 1995" called a "Central Entity" that would act like a super-bank holding company. In the words of their Project 1995 Phase III Report:

"Virtually every finding of Project 1995 points to the need for the system to revise its business principles. The system can no longer afford the luxury of a slow, methodical decision making process that, involves grass roots input to the extent utilized in the past.

"The application of a new set of cooperatively oriented business principles are needed that would:

"1. eliminate corporate structure barriers;

"2. make the delegation to centralized leadership more likely than it is today;

"3. centralize policy making, capital management, and the allocation of system resources."

Under the guise of the present request for federal assistance, the Farm Credit Council's bill would accomplish its Project 1995 goal.

[Attachment 2]

[On November 19, 1985, during a District Stockholders Advisory meeting of the FLBAs, PCAs, OFIs and Cooperatives along with members of the Texas District Board, the following legislative comments were discussed and are now being submitted for consideration:]

LEGISLATIVE COMMENTS

1. The district may be assessed for no more than .1 percent of loans outstanding per year in the form of an investment in the Capital Corporation not to exceed .25 percent of loans outstanding. A dividend on such investment will be established by the Capital Corporation board but in no event will be less than the average cost of debt of the FCS, determined annually. The dividend will be cumulative and not taxable until paid.

2. Loan loss reserves should be retained, but subject to transfer to the Capital Corporation or any other entity.

3. Setting of interest rates will be totally a district bank prerogative.

4. Approval power should be removed from FCA and their role limited to an FDIC type arms-length regulator.

5. The district director at-large should be elected at-large by the association stockholders.

6. Initially, the three board members of the Capital Corporation should be selected from the non-receiving districts.

Three regions, consisting of four districts, should be established. One board member should be selected from each region for a six-year term. Selection should rotate every six years among districts within the three regions.

7. Establish separate district boards as proposed in Senate 1790.

8. Regulate FCSCC so that it neither becomes a holding company nor operates in competition with primary lenders.

9. Preserve the historic discount rights and privileges of Other Financing Institutions (OFIs) and do not jeopardize their investment in the Banks.

[Attachment 3]

CONSIDERATIONS SUGGESTED BY TEXAS FARM CREDIT BOARD CONCERNING HOUSE 3792

1. Farm Credit System Capital Corporation.—All directors will be elected from District Boards that do not receive assistance from the Capital Corporation.

Alternate or Fall-back Position.—When government capital is injected into the Capital Corporation, then additional Board members are appointed by the Governor of the Farm Credit Administration from or representing the public sector.

2. The Farm Credit System Capital Corporation should be a vehicle to utilize System resources in a prudent, businesslike manner, consistent with sound banking practices, so that the likelihood of requiring infusion of public funds will be minimized.

Accordingly, the Farm Credit System Capital Corporation should be authorized to hold loans and loan related assets only for the purposes of orderly liquidation and the stabilizing of asset values.

3. Assets purchased from institutions by the Farm Credit System Capital Corporation will be purchased at recovery values, as determined by policy established by the Farm Credit System Capital Corporation Board of Directors.

4. System levies shall be an investment in the Capital Corporation to be repaid with a reasonable rate of interest (deferred) after government capital is repaid.

5. The Farm Credit System Capital Corporation can draw funds from other System institutions by steps requiring stock purchases or assessments under guidelines set by the Farm Credit System Capital Corporation Board of Directors.

(Discussion—How can FCA help manage the Farm Credit System Capital Corporation and, at the same time, be an effective arms length regulator? In effect, as now, FCA would be regulating itself. Everybody—Congress, the Administration, the Farm Credit System—admits that an "incestuous" relationship is a major part of the problem in the past regulation of the Farm Credit System by FCA, Also, until government funds are infused into the Farm Credit System, the System should remain "privately managed and directed.")

[Attachment 4]

POTENTIAL EXISTING SOURCES OF ASSISTANCE TO THE FARM CREDIT SYSTEM

The Farm Credit system is currently seeking immediate enactment of major legislation which, in addition to providing massive government assistance, would structure the Farm Credit System in ways that would make the Farm Credit System Capital Corporation into a "super-bank."

Before taking such drastic steps because of time pressures, the following existing potential sources of governmental assistance should be explored.

1. FARM CREDIT SYSTEM

A. Existing Revolving Funds.—Two separate revolving funds and certain otherwise unappropriated monies of the Treasury are available to the Governor of the Farm Credit Administration for temporary investment in Farm Credit System Banks. The sum currently available appears to be $256 million. 12 U.S.C. § § 2151 and 2152.

2. FEDERAL RESERVE SYSTEM

A. Purchase of farm credit system bonds, debentures, and similar obligations.—Subject to certain restrictions, Federal Reserve Banks are authorized to purchase and sell Farm Credit System bonds, debentures, and similar obligations. 12 U.S.C. § 2158.

B. Federal intermediate credit bank debentures.—Subject to certain restrictions, the Reserve Banks are authorized to purchase and sell debentures and like obligations issued (individually or on a consolidated basis) by Federal Intermediate Credit Banks. 12 U.S.C. § § 350 and 1040.

C. Discount window operations.—The Federal Reserve Banks may discount (1) certain agricultural paper, or (2) notes payable to and bearing the endorsement of the Federal Intermediate Credit Banks that cover loans and advances under Sections 2.3 (a) and (b) of the Farm Credit Act and that are secured by paper eligible for discount by Reserve Banks. 12 U.S.C. § 349; 12 C.F.R. § 201.6.

D. Federal open market operations.—In conducting its open market operations, the Federal Reserve System is authorized to purchase acceptances of the Federal Intermediate Credit Banks whenever the Federal Reserve Board declares that the public interest so requires. 12 U.S.C. § 359.

E. Emergency Credit for Corporations.—In unusual and exigent circumstances a Reserve Bank, after consultation with the Federal Reserve Board, may advance credit to corporations that are not depository institutions if, in the judgment of the Reserve Bank, credit is not available from other sources and failure to obtain such credit would adversely affect the economy. When collateral used to secure such credit consists of assets other than obligations of, or fully guaranteed as to principal and interest by, the United States or an agency thereof, an affirmative vote of five or more members of the Federal Reserve Board is required before credit may be extended. Although it appears that this provision has not been used for decades, it should be explored as a potential source of assistance. An issue presented, among others, is whether Farm Credit institutions constitute a "corporation" within the meaning of the statute and regulation. 12 U.S.C. § 343; 12 C.F.R. § 201.3(c).

F. Advances to Corporations on Obligations of the United States.—Subject to such restrictions as the Federal Reserve Board may impose, Reserve Banks may make advances (for periods not exceeding 90 days) to corporations on their promissory notes which are secured by direct obligations of the United States, or by any obligation which is a direct obligation, or fully guaranteed as to principal and interest by, any agency of the United States. 12 U.S.C. § 347d. To the extent that Farm Credit institutions hold U.S. government obligations in their portfolios, their ability to secure advances from the Reserve Banks, collateralized by such obligations, should be explored. Again, an issue is presented as to whether Farm Credit institutions constitute "corporations" within the meaning of statute.

3. U.S. TREASURY

A. Investment of Operating Cash of Treasury.—Under 31 U.S.C. § 323, the Treasury, in managing U.S. cash, may invest for a period of ninety days in obligations of depositaries that maintain treasury tax and loan accounts, subject to collateral requirements. When designated by the Secretary of the Treasury, the Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives are authorized to serve as depositories of public money. 12 U.S.C. §§ 2012(14), 2072(12), and 2122(12). These provisions may offer a vehicle for temporary investment of U.S. Treasury funds in Farm Credit System obligations.

4. OTHER

A. Commercial Bank Purchases of Farm Credit System Bonds.—Member banks have authority to purchase system obligations. 12 U.S.C. § 2158.

The CHAIRMAN. We will put into the record the statement of Senator McConnell [1] that he asked be included, as well as the statement of Roger B. Sledd,[1] who represents a group of Farm Credit System borrowers in Kentucky.

Our next panel is Robert A. Carson, chairman of the board of First South Production Credit Association of Jackson, MS; and, James H. Gilfoil III, member of the board of directors of the First South Production Credit Association of Jackson, MS, and we have a very distinguished Senator who wants to talk about these two gentlemen.

If you will present them, Thad.

Senator COCHRAN. Mr. Chairman, thank you very much. It's really an honor and a pleasure for me to present to the committee my good friend Bob Carson who is chairman of the board of First South Production Credit Association of Jackson, MS.

Bob is a cotton and soybean farmer from Lambert, MS. He's been president of the Delta Council which is a leading organization in the South of farmers and businessmen and women who provide very important leadership to the agriculture sector in our part of the country.

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[1] See p. 330 for the prepared statement of Senator McConnell and p. 331 for the prepared statement of Mr. Sledd.

James Gilfoil is a member of the board of directors of First South Production Credit Association of Jackson. He's a cotton and grain farmer from Lake Providence, LA. He's also a friend and has provided me from time to time with good quality advice and counsel.

I think you will find, Mr. Chairman that he and Bob both are very bright, very competent, in not only the farming area, but also in business as well.

I think the testimony they'll present to the committee this morning will be very helpful in our understanding of some of the self-help that is available to the production credit associations around the country.

They're going to tell a story that I know will be interesting to the committee, how we have combined in our region production credit associations of three States to bring down interest rates to farmers and stabilize the lending institutions that are represented by the production credit associations.

But that's for them to describe for you. I just want to thank them for being here and for helping the committee in the way that they have by being part of our hearings on farm credit.

The CHAIRMAN. Gentlemen, we welcome you. I will say that you have just been presented by one of the finest members of the U.S. Senate. He is effective. He is one Senator who does his homework, and knows what he's talking about. We're very proud of Senator Cochran, and I'm proud to have him as my friend.

I will say, as you've heard me say, if you have a prepared statement and wish it printed in the record as if read—as we say on the Senate floor—that will be fine, or you may read it.

Let me identify Senator Boren of Oklahoma. I don't know whether you've met him or not, and of course Senator Boschwitz is next to you, sir. You may proceed.

STATEMENT OF JAMES H. GILFOIL III, MEMBER, BOARD OF DIRECTORS, FIRST SOUTH PRODUCTION CREDIT ASSOCIATION, JACKSON, MS

Mr. GILFOIL. Thank you, Mr. Chairman.

I'm James Gilfoil, and I want to thank first Senator Cochran for that very kind introduction.[1]

I would like to state that I feel very deeply the personal honor accorded to me in allowing me to appear before what I regard as the greatest forum not only in the United States, but in the world, that is, the Congress of the United States.

I am humbled at the same time, in that we are appearing here after having heard this morning from various people in high places, and I want to stress that I and Mr. Carson are both farmers, primarily, as is our constituency.

We also serve by the choice of other farmers on the board of directors of the First South Production Credit Association.

Now, I had intended to begin and to go into my remarks concerning the genesis of the First South Production Credit Association.

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[1] See p. 401 for the prepared testimony of the First South Production Credit Association.

But as a preliminary, I would like to clear up something that I perceived as becoming, perhaps, a misunderstanding in my appearance before the House committee and subsequently here.

My having heard testimony and heard questions that seemed to indicate maybe that some regard the Farm Credit System as being some great thing, some entity. Some monster. That we addressed as a separate thing apart from those who make up its being.

So I would like to define what the Farm Credit System is. It is an association, a loosely knit, but very broadly based, and numerous in membership group of farmers gathered together to provide themselves and those of like occupation with a dependable source of farm credit.

So we can't speak of the Farm Credit System as some monster in the distance, or some monster over our head. We have to think of the Farm Credit System as being this group of farmers and if it's acting in a way that it should not act, it is our responsibility to do something about it.

Now, we in the First South Production Credit Association saw some 2 years ago the problems that were coming to be. We tried to find some way of addressing those problems. At that time we were divided into numerous local associations. We had been that way for many years, and we liked it that way.

But we came to realize that it wasn't possible to continue in this guise, because it simply wouldn't work under today's circumstances.

So we looked at various ways that we might proceed to make things better for ourselves. We had loss-sharing agreements. But the loss-sharing agreements had turned out to be nonproductive in the sense that they just wouldn't work under the circumstances we faced.

So what did we do? We started first to try to merge into more than one system in the State, sometimes three, sometimes four. But at least talk about it. This evolved into a situation where in the State of Mississippi they finally concluded to merge that State into two associations.

In the State of Alabama, I believe the number was four. But as is so often the case, in our part of the country, Louisiana is a kind of a renegade place, and we were subject to squabbling very much among ourselves. And we got into one great squabble.

We talked about merging into four associations, and we talked about merging three. We talked about merging into two, and we talked about merging into one in the State. But we never could reach any conclusion, and we did everything but fight with one another, and we did that on a verbal basis, certainly.

But we simply got nowhere. Then, finally in one meeting this past January—and we all knew things had come to a desperate state of affairs. We'd been arguing all morning, and we had just run out of wind. We were sitting around that room, and let me emphasize here that nobody was directing us. We had no employee telling us what to do. We were gathered as directors of our respective associations.

It came to my mind that maybe I could tell a little story that might help things along, and demonstrate the predicament we were in. So I proceeded to do that, and that story being this: That we could look back to another very great time of trouble in our history, and look at particularly our part of the country, and remember what happened in the Civil War, or as my friend Bob has reminded me to say, the War Between the States—because I don't know if our yankee friends would know what we were talking about it if we referred to it in that guise.

Anyway, I pointed out to this group that one of the chief reasons that led to the defeat of the South in that war——

Senator BOSCHWITZ. They're still talking about that down there.

Senator COCHRAN. You ought to listen, too, Rudy. [Laughter.]

Mr. GILFOIL. It's little known, but a perfectly true thing that one of the great reasons for our defeat was the very nature of our system of government, that being a confederacy. We were a confederacy of autonomous States, and each State was jealous of its own prerogatives. Each Governor wanted to maintain his own army, he wanted to keep his army at home, he wanted to name the commander, and he didn't want to subject his troops to the command of a general from another section.

Therefore General Lee was in probably the worst circumstance any commander of a military force in the history of the world, in that he did not command all of his troops. It led to a calamity, as far as the South perceived it at that time. Only in the last days of that war was he given complete command, and by then it was too late. When I told this story, and drew this parallel, it seemed to ignite this group some way to move again in the direction of trying to get something done.

So the idea was raised of why not let us go all the way. We can't agree on two, three or four associations in the State; we can't even agree on one. Why not go as far as we can go and agree to proceed with one for the Fifth Farm Credit District. And then we will have done all that we could possibly do as directors.

So we proceeded with this idea. Some of us went as emissaries to the other States. We talked to groups in Alabama—of directors. We talked to groups of directors in Mississippi, and we formed a task force to work out the problems attendant to this merger.

I would like to say that we were successful in accomplishing our purpose. It wasn't easy. We struggled with it. We fought over it for months. But we finally came together and we did form the First South PCA.

I turn it at this time over to Mr. Carson to tell you a bit more about the accomplishments and objectives of that association.

Senator COCHRAN. Thank you very much, Mr. Gilfoil. We appreciate your presentation. Bob, you may proceed.

STATEMENT OF ROBERT A. CARSON, CHAIRMAN OF THE BOARD, FIRST SOUTH PRODUCTION CREDIT ASSOCIATION, JACKSON, MS

Mr. CARSON. Thank you, Senator.

Members of the committee, I would like to identify myself as chairman of the board of the 21 directors of First South Production Credit Association which is headquartered in Jackson, MS, and it makes up, as Mr. Gilfoil said, the States of Louisiana, Mississippi, and Alabama.

We had perceived for quite some time that we had a problem in agriculture. The problem still exists. It will not be cured by what we have done or by what this committee action will be today. The problem in agriculture is credit, and credit's problem is a lack of profitability in agriculture.

It can be handled all over this Hill, in all the committee rooms. It's going to have to be, you're going to have to look at fiscal policy, foreign policy, defense policy, farm policy.

The farmers cannot carry it by themselves, nor can the defense contractors carry it by themselves. Unfortunately, we cannot raise tanks in our fields or missiles. If we could raise guns, then we might have a source of income, where farmers become profitable.

But we're dealing with a lack of profitability which you don't have to have explained. It was this knowledge and understanding that this lack of profitability existed that made us decide to do all that we could do on our own before we came back to the Hill and asked for anything.

Now, there's no indication whatsoever that agriculture or anybody else should come to the U.S. Treasury for survival. It just ought not to be. The greatest country in the world has no system, apparently, to see to it that agriculture can survive without the U.S. Treasury. This has got to be changed.

But we couldn't change it by ourselves. So we did what we could at the grassroots level, to bring about a unified production credit association that could cut costs.

Mr. Gilfoil told you that we did it with grassroots people. There were no employees involved in any discussions that we had. If we wanted outside information, we requested management to get an outside auditor. We did not want people within the System reporting to us about what we should do. We wanted clear minds and a different thinking to tell us what to do.

After an extensive investigation of all the facts, what could be again the pros and cons of merger of these 16 associations, the general counsel and the accountant came in. I asked him the question after he had made his report, when should we contemplate merger, and his answer was "yesterday." He was right. It should have been yesterday.

The likes of people such as me who opposed merger, we wanted to defend our own geography, we wanted to keep our own little boards together, we wanted to keep our own little act together. I was wrong. I was desperately wrong.

But we went forward, and we put together a 21-member board of one association. We had two things that we wanted to accomplish. First, we wanted to achieve greater efficiency and effectiveness in business by consolidating our capital and human resources.

Second, we wanted to maintain local grassroots support and direction for our loan servicing operations. This past September we finalized the merger. As a matter of fact, in less than 12 months time, because of mergers that were taking place on a smaller scale and then expanding and whatnot, I happen to have the distinction of being chairman of the board of three different production credit associations in less than 12 months. That's moving.

But we feel like that each time we were progressing, and as I look back on it, I should have taken the big step the first time, and then we wouldn't have had to go through all the other preliminaries.

But believe you me, when we got to this one for the district, farm credit had been so greased that they knew exactly what to do, there were no delays. Frankly, I think it was approved before we ever submitted it.

But we went to our stockholders. We had 92 percent support of those who voted, in favor of it. Some of the stockholders were getting accustomed to it, because I say we had already been through it with some of them, just in the previous 3 or 4 months.

But we had grassroots support. Now, I'll admit to you that time and tide make a difference in how people react. We are in trouble. Agriculture is in trouble. People were not too prone to question too much or to stand up and say no too hard when anything might be better than where we were.

But I have to impress upon the committee that it was done from the grassroots. It was done without employees of the System. It was done on our own free will, and had the first time anybody connected with the System come down and told us you've got to do so and so, it would have stopped dead in its tracks.

There are not any more hard headed people in the world than farmers, and they really don't understand when it's to their advantage to do something.

A lot of times they don't, and I point to myself in that respect. But we were never interfered with. We were given a free rein. We could go in any direction we wanted. And we came up with an organization on our own free will that we maintain will work all over the United States.

If grassroots directors are permitted to get in a room by themselves, do all their infighting and fussing and cussing in there, and then when they come out, come out of one mind. But you cannot mix up employees who have to do with operation and directors who have to do with policy.

We set the policies. Frankly, gentlemen, we have more control over this production credit association than we ever had over the 16 or the 26, for which we had five directors for each one of them.

We have a view of the total operation across our area. We have set all the policy and the direction has gone out to management that anything we do, if it does not benefit the farmer, we don't do it.

We have not set up an organization to make a position for an employee. We expect performance, top performance. Believe you me, we've cut down enough people, both at the FICD level and the PCA level, that we've got people who know their jobs depend on their performance.

No longer is there a situation where it's strictly one great big welfare organization, and because they've got longevity they're there. Performance. And it's got to be in the benefit and interests of the farmers. We have no organization whatsoever for employees only.

Senator BOSCHWITZ. Mr. Chairman, I would like to ask these gentlemen some questions. We have a vote, as you can see, on the floor.

Senator COCHRAN. Why don't you ask your questions now. I know that Senator Helms is on his way back. He's gone to vote. He's coming back.

Senator BOSCHWITZ. I would like to know, your PCA is one of the smaller groups, I think, if not the smallest. Perhaps Springfield is smaller.

You say it was all done from the grassroots. Do you then disagree with the idea that the whole structure of the Farm Credit System has to be changed?

You can do it with the rules and regulations that are now in effect?

Mr. CARSON. Yes, sir; you can. It depends on your attitude, your approach.

Senator BOSCHWITZ. You said you want to cut costs. You cut down enough people, et cetera.

How have you succeeded in that? You haven't given any figures. By what percentage have you cut your costs?

Mr. CARSON. We've cut our costs from 18 percent at the bank level and some 13½ percent at the local level. We cut our people, we cut out programs. We cut out all of the fat that could have been any way in the System, and we pooled our capital.

You must understand, Senator, that after taking a $60 million lick over about the last 3 years that there was not an association that had any reserves left. We pooled our capital with the FICD capital. We were one, and we did not then have to have the reserves——

Senator BOSCHWITZ. If you had so few reserves or if your capital was so eroded, how can you give these large decreases in interest rates?

Mr. CARSON. Part of it, Senator, was that we——

Senator BOSCHWITZ. What has that done to your profitability?

Oh, we're going to have to go.

Senator COCHRAN. Why don't we do this: Senator Helms has gone over to vote and he should be returning momentarily. Senator Boschwitz and I need to go vote.

So, why don't we recess and we will reconvene when Senator Helms returns.

[A short recess was taken.]

Senator ZORINSKY [presiding]. We are going to start now. Would the panel that was here before please sit.

I am going to call on Dr. Steve Hanke to try to expedite this and have him give his testimony and then when the rest of the members come back, they have some more questions they would like to ask the panel from Mississippi. So, if you would stand by, the panel from Mississippi, and then we will take an additional witness, Dr. Steve Hanke, the professor of applied economics at the Johns Hopkins University in Baltimore, MD.

And would you give us your testimony, please, sir?

Dr. HANKE. Yes; I would.

Thank you.

STATEMENT OF STEVE HANKE, PROFESSOR OF APPLIED ECONOMICS, JOHNS HOPKINS UNIVERSITY, BALTIMORE, MD

Dr. HANKE. For purposes of the record, I would like to request that my entire written statement be included.[1]

Senator ZORINSKY. Thank you.

We appreciate it, and without objection, your entire statement would appear in the record, as if given in its entirety.

Dr. HANKE. Thank you, Senator.

Before I get into the heart of the proposal, let me just state a few basic premises upon which my approach is based. First, I believe that aid to businesses, whether they be farmers or anyone else, is not a proper role for the Federal Government and a proper use for the taxpayers' money.

In any case, my second premise would be that most farmers are not on the verge of business failure. The third item would be, therefore, that the agricultural financial system is not about to collapse and pull the U.S. financial system along with it.

The next item, as a premise, would be that a bailout would only rekindle overpricing of farm assets and lead to another speculative bubble. In summary, these premises get back to what Senator Helms was talking about with regard to his banker friend down there, in North Carolina. I think that basically, Senator Helms, these premises that I am going over right now and that I base my policy prescription on, are in line with your banker friend and his point of view.

I believe, again, along the lines of Senator Helms' banker friend that any proposed solution that ignores the need for a significant reduction in the amount of borrowed capital employed by American agriculture is doomed to fail.

So, even though I conclude that a bailout would be inappropriate and unwarranted at this time, I do think that the current situation does offer some opportunity for reform that could, in fact, strengthen not only the financial system but the agricultural sector of the economy. The Farm Credit System comes into play here because there is some qualitative stress being placed on the System. I would agree to that and I think that we can use this opportunity to simply strengthen the whole operation.

My proposal really has two elements. Let me just briefly outline what they are.

The first element would be to accommodate the need for reduced credit in agriculture. I would propose that new loans from Farmers Home be terminated.

Part 2 of the proposal would be that the existing portfolio, about $25 billion at present that Farmers Home owns, would be transferred for servicing over to the Farm Credit System.

So, we have a two-part deal here: No new loans would be made by Farmers Home and the existing Farmer Home portfolio would be transferred over for servicing to the Farm Credit System.

Now, that transfer would bring in a net profit to the Farm Credit System. I have estimated it to be about $500 million a year. I arrived at that figure by looking at the portfolio, $2.5 billion applying a servicing fee of 2.5 percent to that, and you have got gross revenue of about $625 million.

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[1] See p. 414 for the prepared statement of Dr. Hanke.

From that it would be fairly cost effective for the Farm Credit System to service this because they do have a large system that is, in fact, underutilized to some degree at present, so that the cost of servicing that big portfolio would be about $125 million a year. That leaves a net profit of $500 million a year. At 10 percent, if you capitalized $500 million, that is equivalent to temporary capital infusion of $5 billion into the Farm Credit System.

So certainly, I think that the servicing of that portfolio would relieve a considerable amount of stress on the System, it would avoid the need for a bailout, and it would accommodate the need for a reduction in the total amount of credit in agriculture by knocking out a massive Federal component of the agricultural credit system.

So, I think that you would have an opportunity to, in effect, kill two, if not more birds with one stone, with this policy proposal.

That concludes my summary of the testimony.

The CHAIRMAN. Well, I want to read all of your testimony Professor Hanke. I don't know whether it was mentioned or not but Senator Symms, the very fine Senator from Idaho, recommended you and he described you as a fellow with eminently good commonsense.

We are delighted that you are here.

Do you have questions, Ed?

Senator ZORINSKY. I have no questions.

The CHAIRMAN. What you are saying, you say it better than I do, but I will simplify it, you are saying do not put the cart before the horse in approaching this problem. Look at what needs to be done in correcting the defect, before you think about monetizing the bailout, if you want to use that word.

Dr. HANKE. In a way, if you get into one of these bailout proposals, and all of these other proposals are in one way or another bailouts, you will do what you did in 1978 and 1981 with emergency farm credit: you will keep land values artifically inflated, and at some point, down the road, someone will have to face the problems associated with a speculative land bubble.

A bailout would not get at the source of the problem which is too much credit in agriculture and too much speculation in land which allows us or puts us in a situation where we cannot compete effectively internationally. Too much credit in agriculture really hurts us because it generates artificially high capital costs.

What you really are doing with a bailout is just creating a speculative bubble and eventually the thing has to pop unless you can keep tapping the taxpayer for money to pump into the System.

The CHAIRMAN. Well, the last thing that we need on this would be to politicize it, if you start with the amount of money then it becomes a game of oneupmanship, somebody offers more money without addressing the real problem.

Well, I thank you very much, Dr. Hanke, and one of these days, I would like to visit with you.

Dr. HANKE. I would appreciate the opportunity to do that.

The CHAIRMAN. Thank you very much.

Rudy, do you have a question?

Senator **Boschwitz**. I am sorry I missed your testimony, Dr. Hanke. As a matter of fact, I am an alumnus from Johns Hopkins and majored in economics. But did I read something that you had written recently, or somebody at Johns Hopkins that there should be an amalgamation or that at least it should be considered of the FmHA and the Farm Credit System?

Dr. **Hanke**. Well, that probably was something that I had written. My proposal is really one in which the Farmers Home is terminated in terms of new incremental loans, and the existing $25 billion Farmers Home portfolio is taken over for servicing by the Farm Credit System. They have a lot of excess capacity. They have an effective nationwide system for the delivering and servicing of credit. Let them service the Farmers Home portifolio, Senator, and they would make a net profit, I estimate that it would be $500 million a year, and if you capitalize that at 10 percent interest, the annual income is equivalent of a temporary capital infusion of about $5 billion.

Senator **Boschwitz**. It is interesting. There is a duplication of systems, Mr. Chairman, but what Professor Hanke says has merit in my judgment.

While I agree that there might be too much credit involved in the whole business of agriculture and that is part of the problem, a large part of the problem is the farm bill that we are going to work on, on the floor this afternoon, and there certainly is not much sentiment to let the market work. As a result, part of the problem is my problem with that farm bill as well.

I am interested in the idea of relating it to the FmHA and the Farm Credit System quite clearly. In the plan that I have outlined—I would like to give you a copy so that you can review it—I said that the FmHA, the window of the FmHA has to, in some way, be adjusted otherwise the bank and the PCA and so forth, are just going to refuse credit, and send their borrowers to the FmHA and use the proceeds to pay off their own bad debts and the Federal Government is going to pick up all of this bad paper.

Dr. **Hanke**. In my view, if I could comment on your general views on the farm bill as I interpret them, some of the ideas that you have had in the past would require the Government to pay farmers a one-shot or several-shot fee to get farmers weaned away from Government payments, if you will. Your proposals, coupled with the kind of thing that I am talking about, I think could get us out of this farm mess.

If we do not move in this direction, I see little hope for agriculture. We will just continue wallowing around in this crisis atmosphere for ever.

Senator **Boschwitz**. I am just having a tremendous problem getting Senators to have any confidence in the fact, that if you set the loan rate low enough, make a transition payment above the loan, that will keep farmer at its present level for 1 year, and then transition it down, but the farmer, keep everything above the loan, $1.90 in corn, $2.20 in wheat, the 10 year average price on wheat $3.35 so that he would keep everything above the loan and there would be an enormous opportunity.

Maybe even too large an opportunity, very frankly, maybe we would monetize and start the cycle of land going up again and get ourselves in the same problem. But we could put a lot of money in agriculture if we allow, as the transition comes down, allow the free market to give it a little upside.

But I cannot sell it. Most of the Senators want a guarantee that they are going to get a certain amount every year. I will talk to you after this is over.

I wanted to ask the gentleman from Mississippi a question. We were beginning to talk about cutting costs, that what has been your profitability, the impact on profitability? What were the profits of this system that you amalgamated last year and what do you perceive it is going to be this year?

Mr. CARSON. Let me first tell the Senator that what we did to bring down the interest rates. First, there was a drop in the cost of funds. We were just that lucky that the discounts and the Wall Street money came down about the time that we put it together. If you look on page 3 there, under No. 17, it is there.

Second, we were able to consolidate and control the fifth district FICB, and PCA capital. We have a unique situation, Senator, in that the president of the FICB in the Fifth Farm Credit District, is also the chief executive officer of the First South PCA. The gentleman is wearing two hats and it is a difficult position and we counsel and talk with him regularly that if it ever becomes unbearable, that we can change that arrangement. But because we were without capital, the bank had capital, it behooved us to have a common CEO for both operations.

Third, there was a reduction in operating budget.

If you will look over on some of the accomplishments behind that interest rate schedule, you will see that the amount, how the budget was cut, how the number of people were dropped from the employment and generally we are just getting down to a survival mode that we can have just enough people to provide the services that the System needs.

Senator BOSCHWITZ. Let me ask the question again.

What were the profits of these associations last year? What do you anticipate the profits of this combined association to be this year, in relationship to last year?

Mr. CARSON. Profits for the combined associations had we not made a change would have been negative, sir.

Senator BOSCHWITZ. And what do you anticipate them to be——

Mr. CARSON. We anticipate them to be about a $3 million profit this year.

Senator BOSCHWITZ. On what kind of volume?

Mr. CARSON. On about $325 million.

Senator BOSCHWITZ. And that is the income that you have, $325 million?

Mr. CARSON. We have about $325 million loans outstanding.

Senator BOSCHWITZ. I just, as a quick measure, thought that you had about $900 million.

Mr. CARSON. That would be then, I think, if you went up to those numbers, you would be talking in terms of land bank and land bank co-ops, would you not?

Senator BOSCHWITZ. No.

I noticed that the, in the Jackson district, that these PCA's have 18.4 percent of the short-term debt and that the entire district has

4.8 percent of the total short-term debt, which is about $5 billion and 18 percent of $5 billion is $900 million.

That is not accurate?

Mr. CARSON. We are not operating on that much now, sir.

Senator BOSCHWITZ. No?

Mr. CARSON. No, sir.

Senator BOSCHWITZ. Well, I must tell you that the reason that I asked these questions is that we will watch with care some of the districts, your district which is in very good shape and some of the other districts are not in as good shape. We will watch because we are hearing some of the other districts say, oh, look at those folks in Jackson, they are dissipating their capital by lowering their interest rates so that we are not going to have to send any of our capital to a central bank in Witchita, down to wherever it is, in order to bailout some folks in Senator Zorinsky's district hopefully not in mine, but maybe in my district as well.

So I want you to know that we looked at the Federal Farm Credit System as being a unit, as being unified, very much the way Mr. Gilfoil spoke and that we will watch so that we protect the interests of Jackson, and we also will protect the interests of the other districts that are very sensitive.

Let me respond a little bit to Mr. Gilfoil, if I may, in his references to the Civil War.

It is an unfortunate thing that General Lee, who lived right across the Potomac chose to stay with Virginia rather than come across the river, as close as he was and most of his friends had gone to the military academy and encouraged him to do so. The war would have been a lot shorter and there would have been fewer lives lost.

Mr. GILFOIL. I would suggest to the Senator that that is a matter of opinion and perspective.

Senator BOSCHWITZ. But when you say that he did not have full command, you will remember the series of generals that President Lincoln had, starting with McClellan, who, as Lincoln said, had the slows, he never could make up his mind, and whenever they suggested that he attack, he said that he needed 200,000 more troops because he was so afraid of Lee. He just created great indignity for President Lincoln by not even allowing the President to come into his tent sometimes.

After Lincoln, there came others and they were also hard, until they got—and that was the first time that the Union got a unified command, too, Grant insisted on it.

Mr. GILFOIL. Well, Senator we would be glad to allow you in our tent and furthermore we would be glad to come to yours if we are invited.

Senator BOSCHWITZ. Thanks, I like that.

I used to trade a great deal with some people in Jackson, there, in the veneer business, father and son, I forget his name now.

Mr. CARSON. Senator Boschwitz, let me assure you sir, that if there is a shrinking of the capital base of the FICB, it is not being done with any attempt, whatsoever, to not to support the sister banks across the United States.

We had a policy decision to make, in that, putting together this First South PCA, we could reduce our profits which could have been above the $3 million figure that I gave you, we could have increased them, by increasing interest rates. We felt at this time, in the best interest of the farmers, that we did not need to improve our reserves, we needed to make the best deal available to agriculture producers that we could. This was the intent of our entire program.

Senator BOSCHWITZ. Are you suggesting that you are now—are you now shrinking your reserves then?

Mr. CARSON. No, sir, we are not shrinking our reserves.

I thought that I heard you say that you were watching closely the Jackson situation to see if they were pulling down their profits so that they would not have loss sharing with another district. I wanted to assure you that there was no intent or no reason to feel that way at all because, in fact, we are here supporting some help for the Farm Credit System, simply so that we can get some funds back into the Jackson district that have been sent to Omaha and to Spokane, because we have weakened ourselves and we need those funds back.

If there is no help from the Federal Government, we are going to survive on a systemwide basis, but it is going to be tough for agriculture producers.

Senator BOSCHWITZ. The next witness would be Mr. Johnson, is that correct, is he here?

Mr. GILFOIL. Senator, may I make a concluding remark?

Senator BOSCHWITZ. Sure, about the Farm Credit or——

Mr. GILFOIL. About the Farm Credit, yes, sir.

We in the Farm Credit System, speaking of the separate banks, the Federal Land Bank——

Senator BOSCHWITZ. Pardon me, will you start again?

Mr. GILFOIL. I said, we in the Farm Credit System, that is, the Federal Land Bank Association, the FICB, PCA arm, the Bank for Cooperatives fully understand that we endorse, in effect, each other's notes in the capital markets of the country.

We, as individuals, in the Production Credit Associations endorse each other's notes. I would hope that the Senators would keep in mind, when they hear from other groups or when they hear from dissidents, who do not like what has gone on, particularly in the matter of how loans have been handled for individuals, that you keep in mind that there were other individuals involved in these decisions, and that these people had, in fact, endorsed these people's notes.

So, any time that you jeopardize the whole association for the benefit of one or two, you are not only jeopardizing the other members' interests, you are increasing their interest costs.

I think that needs to be fully taken into account. I think that it is a fact little realized and you can hardly criticize an institution for protecting itself and at the same time, criticize it for not being much more liberal.

We are, whether we like it or not, in fact, our brother's keeper. That is continually brought to mind when we come into these crisis situations.

Thank you, very much.

Senator BOSCHWITZ. I recognize that. I am going to have to adjourn or recess for just a few moments. I have to go over to the Senate.

I recognize what you are saying, Mr. Gilfoil, and I am pleased to hear your comment, and I must say that I admire it. The fact that Alabama and Mississippi and Louisiana can join together and make the savings that you speak about and I will look at this booklet that you presented us with some care. It may, indeed, give us a direction that we can push some other people in, because if you are really saving some dough and if you are making yourself more efficient, that is what it is all about.

I recognize that there has not been a great need, when there is not much of a need, not much gets done. I have to excuse myself, Mr. Carson, but I do need to go over to vote and therefore, the committee will stand in recess until Senator Zorinsky returns, to hear additional witnesses.

[Whereupon, the committee recessed.]

Senator ZORINSKY [presiding]. The committee will come to order.

I would like to call Wayne Johnson as our next witness. Mr. Johnson is a farmer-feeder from Ainsworth, NE, which is in north-central Nebraska. He has been a borrower and a member of the Valentine Production Credit Association for 20 years and a director of the local Federal Land Bank Association for 11 years.

Mr. Johnson has served on the director/advisory committee of the Omaha Federal Land Bank for 3 years. Mr. Johnson has first-hand knowledge of the many problems of the Farm Credit System at the local level, and we look forward to his testimony.

Please proceed, Mr. Johnson.

Mr. JOHNSON. Thank you, very much.

STATEMENT OF WAYNE JOHNSON, MEMBER, VALENTINE PRODUCTION CREDIT ASSOCIATION, AINSWORTH, NE

Mr. JOHNSON. Thank you, very much. I appreciate very much the opportunity to come before this prestigious committee and at your invitation, Senator, and my remarks will be probably quite brief.

Senator ZORINSKY. If you have any prepared remarks, we will put them in as if you gave them in their entirety.

Mr. JOHNSON. Yes; I do have a prepared statement and I will make a few remarks beside that.[1]

A lot of this ground has already been covered here by previous people giving testimony and I especially appreciated Mr. Humphrey from Minnesota, he had some real good testimony on what is actually happening to the borrowers out there.

If you will recall, 1 year ago, the Farm Credit System, and I will speak mostly about the Omaha Bank, because that is the one that I am, of course, more familiar with. I realize that there are problems in some of the others too, but about 1 year ago, the Farm Credit System was actually in pretty good shape. The Omaha Bank had plans to build a $40 million headquarters building in Omaha, and had land acquisition all set up and everything and did not, you know, there was not any talk of bailout or any real serious problems. And what happened in such a short time in 1 year's time, they are asking for as much as a $5 to a $6 billion bailout. So, there had to be something that triggered this situation in my estimation. What this was, was liquidation of the Valentine and the O'Neill PCA.

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[1] See p. 420 for the prepared statement of Mr. Johnson.

This was ordered, or as I understand, from the Farm Credit Administration in Washington. They got into a position where they felt that they were no longer a viable association, Valentine and O'Neill so that they put them into liquidation, and froze the stock

When this happened, this sent shock waves through the whole four-State area and beyond, because the borrowers had never been told that their stock was at risk. I suppose that they should have known that but they never were told that their stock was at risk in any way, shape, or form.

And when they did this and borrowers all over the four-State area began to leave the PCA and even spilled over into the Federal land bank. Good borrowers who could get away from PCA because of this danger of losing their stock and a lot of them who are left, could not leave and in 1 year's time, now, our PCA in the four-State area is down by one-third. In other words, one-third in numbers and over one-third in dollar volume. So, that if you wait another 2 years, there will not even be a PCA in that four-State area, they will not have any need for one because they will all be gone somewhere else. In other words, this situation of this stock situation, if it is not corrected, there is no point in a bailout because it would just be money thrown down the well. They are going to have to change their policy or rectify this in some manner.

Either a Government guarantee on the stock, or a System guarantee on the stock. And since then, they have found out that there are other PCA's in the area, in southern Iowa and in South Dakota were in the same financial condition as Valentine and O'Neill but they did not liquidate them and freeze the stock, because they knew the ramifications of it were already so apparent that it would have just wrecked the whole System like that.

Not only that, but the stockholders, in my case, and I am not going to use my case, because I am familiar with it and it is accurate, and it is descriptive of what happened to a lot of other people in that area, they did not take me to the PCA, they did some, stockholders were taken to another PCA.

Back about a year ago, my loan was adversely classified. They did this to a lot of them in this area, and put on an extra 2 percent interest and I was never told about this. I discovered this when I renewed my loan and they kept this to themselves. When this extra 2 percent was put on adversely classified loans. Now, I see that the economist has left, but I wish that I could ask him this question: If you have got a borrower or a stockholder who is in trouble, because of a high-interest rate, how can you help him by raising his interest?

Now, I do not know whether you can answer that or not, nobody else has ever been able to answer it for me. But, you know, if you have got somebody who is sick and the medicine is causing him to be sick, you certainly do not increase the dosage and that is exactly what happened.

All right, so I got along—I will say this much, the liquidating agent did a real good job. They have done a tremendous job in that area. He has done some things that the PCA, itself, should have done before they brought in the liquidating agent. He has made deals and really has not foreclosed on anyone. I got along with him real well and by now, I have got myself so that I am going to be completely out of the PCA. I have got them paid off completely. I had to buy $100,000 worth of stock that I have paid for and I am not delinquent or owe one single penny to the PCA. I do not participate in any Government sponsored farm programs. I have made everything out there, we have done without going to the ASCS office, and finding out whether we could plow or not certain fields, we do it on our own.

I just think that if this Farm Credit System is going to survive and have credibility, they are going to have to do something about that stock. That is paramount.

Senator **Zorinsky**. Mr. Johnson, I concur with you. I think that you make an excellent point. It is quite evident that with the experience of the Valentine Production Credit Association, every farmer who possibly could went to private lenders—commercial banks. And that will continue to happen, which will make it more difficult for the System to survive.

Mr. **Johnson**. It also, all through Farm Credit of the banks, of the commercial banks, this frightened them tremendously, too. I mean they were not getting along all that good and you go to a new credit source, at a time when—here I had $100,000 that I did not really owe, charged against my equity, it made it impossible to go to another bank.

That is exactly what it was, it was being held hostage by the stock. And in my case, this is typical and there are a lot of others in the very same circumstance. If it just had not been for the stock deal, I would not have had any trouble at all. I could have just gone right to another bank and I would have gotten along fine. But I am still going to survive it, and they thought that I should be in liquidation or broke by now, but I am not, I am going to be all right. We have got the thing under control.

Senator **Zorinsky**. Well, that is an admirable comment under today's economic situation and you are to be complimented.

Mr. **Johnson**. Thank you.

Senator **Zorinsky**. Senator Boren, do you have any comments?

Senator **Boren**. Well, I just want to comment that the testimony that you have given us, of course, will be in the record. I am sorry that so many distractions have occurred. We have been interrupted here by votes on the Senate floor, but it will be entered into the record for all of the members of the committee to read and I know that they will read it with interest.

I do not think that there is any economist or anyone else that can give you an answer to the question because obviously there is no one in the world who can help the situation of a person who is already under stress by increasing the interest rate that he has to pay. That is one of the things that we were talking about yesterday with the representatives of the Farm Credit System. I think that you have reinforced two points very well: No. 1, if Congress is going to step in and give additional aid of some kind to prop up the

System, we want assurance that they are going to end this policy of increasing the interest rates of those borrowers who are already under stress. There is no reason for the taxpayers to step in and provide assistance, unless there is some sort of guarantee to us that that will cause the system then, to change their policies and to stop this escalation of rates to the family farmer that is already in trouble.

No. 2, I agree that we have a moral obligation to put priority on making sure that those farmers and ranchers who have bought the stock as a condition of borrowing through associations, will have that value of that stock protected.

You have made that point very well, because it is not exactly a voluntary situation and the System, in essence, coerced you into making that investment in order to get the financing. I think that we have a moral obligation to protect the value of that stock for those who have found it necessary to invest in it.

So I appreciate, very much, your taking the time to come and be here.

Mr. JOHNSON. This spilled over into the land bank too. They raised interest rates in anticipation of losses and had they lowered the rate and I told them this at the time that they did it, that they should have lowered the rate instead of raising it, they might not have had the losses. This just forced the losses on them all the more sooner because they raised the interest rate and I do not understand why they cannot see that.

Senator BOREN. I think that you are very correct.

Senator ZORINSKY. Thank you, Mr. Johnson for participating in this hearing. I think that it is vitally important that your words be distributed among the rest of the members. We will make sure that they are distributed.

Mr. JOHNSON. Thank you and I am very happy to have been here and I am proud to have you as the Senator from Nebraska.

Senator ZORINSKY. And David is proud to have you here too. He only has trouble when our football team plays Oklahoma.

Senator BOREN. Your able Senator and I get along very well except for one day of the year, and you can guess which day that is.

Mr. JOHNSON. Yes, I do.

Senator BOREN. But it is going to be a tough one again this year, the way that it looks.

Mr. JOHNSON. Thank you.

Senator BOREN [presiding]. Our concluding witness's today are both from Oklahoma and again, I want to assure them that their testimony will be in the record, and considered by all the other members of the committee.

We have two people that I think have a lot to say about the Farm Credit System that is worth consideration by the rest of the committee and I am very proud to have them here this morning.

The first is Jim Billington, a wheat and cotton and cattle farmer from Altus, OK, who also is the past president of the National Association of Wheatgrowers. He is the former president of the Production Credit Association of Woodward, OK which is in the northwestern part of our State, and now lives in the southwestern area.

He was an examiner for the Farm Credit System as well, in earlier years. He presently serves as the chairman of the National Wheatgrowers International Trade Committee and is the Wheatgrowers' spokesman on credit issues.

So this combination of his experience with the Wheatgrowers in a leadership position with his own personal background of the Farm Credit System as president of the local PCA and also as an examiner of the System, makes him uniquely qualified to comment.

Our second witness today from Oklahoma also brings excellent credentials to this field. Ron Voth is a wheat and cattle farmer from Fairview, OK. He is past president of the Oklahoma Wheatgrowers Association and he is currently a borrower of a Federal Land Bank and Production Credit Association in Oklahoma. I have often said, that I think sometimes we hear from the lenders, and we do not always hear from the borrowers and they are perhaps the ones that it is most important to hear from. He is president of his local conservation district board. He is on the board of directors of the National Wheatgrowers Association, and in addition, Ron serves on the 10th Federal Reserve District's Agricultural Advisory Committee. I am very, very proud to have both of them here today.

I do not know which of you wants to go first, but we will let Ron go?

Mr. VOTH. Thank you very much, Senator.

STATEMENT OF RONALD E. VOTH, FEDERAL RESERVE AGRICULTURAL ADVISORY COMMITTEE, ORIENTA, OK, ALSO VICE PRESIDENT, OKLAHOMA WHEATGROWERS' ASSOCIATION

Mr. VOTH. I want to say thank you for this opportunity to appear before you, Mr. Chairman, and you know, when I think of all that we have heard today, I am reminded of the fact that it took me 4 years to get a college degree, but you know it has taken me 16 years to get over my education. I notice that as time goes on, we all can get over our education and deal with the problems as they are in the real world.

Let me tell you just a little about how the current economic conditions are affecting my own personal operation.[1] We are a family farming operation that, of course, uses large amounts of borrowed money. We have been meeting our cash flow requirements in this past year, but it has just been with narrow margins and with little left over.

Basically this has been done because of three things—my wife teaches school, we had excellent crop yields in Oklahoma over the last 4 or 5 years, especially in my area, and cattle have been somewhat profitable.

And if you are fortunate, you have also had an oil well, which I have not had.

You know, continued high interest and record low wheat prices and erratic cattle prices and continued high cost of production are really just a part of our problem that we are dealing with today.

Many reasons exist for the impending crunch that we all feel, namely some of them are: High real interest rates, low commodity prices, deflation of assets, worldwide recession, faulty management by both lender and farm borrower, and I will also add to this, mismanagement of Government farm programs.

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[1] See p. 423 for the prepared statement of Mr. Voth.

I could also relate statistics that point out how bleak the situation is, but let this suffice to say that today, my tractor is sowing the wheat of a neighbor of mine who lost everything that he had in bankruptcy and foreclosure. So that will tell you how it really is.

Our land prices in northwest Oklahoma have declined 50 percent since 1980. Many farmers who bought land in the last 5 years on borrowed money, have little equity remaining. Neither is the end in sight. We see rising bank loan losses which lead to tighter credit and consequently there are more farm foreclosures, resulting in more bad loans and bank losses, it just goes around and around.

I have been with the Federal Reserve in Kansas City and they have a term, they call this the "unwinding in agriculture." Sometimes they have thought that this was manageable but I think that at the present levels, the unwinding is unmanageable if something is not done soon. The eroding land prices must be leveled out.

We have economists who say, we have too many farmers or some farmers deserve to go broke, because they bought land in the 1970's in the hopes of getting rich. You know, these same economists have forgotten that in the 1970's farmers were educated that when inflation rates exceed interest rates, credit purchases of land were the prudent thing to do.

Farmers did not regulate inflation then and they still do not today. How is all of this crisis that I am talking about affecting rural America?

I think that one good figure that I just picked up from the paper yesterday. October 28, Deere & Co. laid off 480 employees. This latest round of layoffs will reduce Deere's work force in Waterloo, IA, alone, to 7,100 employees, down from 16,160 in the fall of 1979. On top of this, the new farm equipment sales have literally halted with an avalanche of used equipment available to buyers in need.

When profit is in agriculture, I and other farmers, buy vehicles and clothes and equipment in our hometowns. In my hometown of Fairview, OK, which has a population of about 3,600, we have had nine businesses close in our two blocks of Main Street in the last 6 months alone. And it appears to us the jury is out whether rural America is going to survive this or not.

Next June 1, I might say my operating loan with PCA is up for renewal. Now, the question in my mind, as a borrower is, are they going to renew me or not?

My equity has declined this past year and will continue until next spring, and so then with land values declining like they are, my question has to be, where will I be, 1 year from now?

They even reduced my interest rate here, a while back. Everybody that paid down to zero, sometime during the year, got a reduction in interest. And that really did not mean that you had a good loan at all, that means one time during the year, you may have sold a bunch of cattle and paid off.

Are the inefficient the only farmers going bellyup? We hear this a lot. You know, Agriculture Department figures show that 37 percent of all farms with sales of over $250,000 or more are in financial trouble. And the question comes, how is this going to spill over into other financial markets?

Well, it has already spilled over, I will tell you. When I was visiting the Federal Reserve Bank, at Kansas City for a meeting, it appeared to me these men in management almost had tears running down their face, and afraid to answer the telephone, knowing that hey, there is another one that we are going to have to close up.

In the United States there have been about 100 banks that have failed in 1985, or close to it, and they possibly expect 200 in 1986. And 40 percent of these are agricultural banks. To even bring this closer to home and Senator Boren knows this, he has heard this too, we have had five rural banks in Oklahoma that have been declared insolvent just in the northwest area of Oklahoma in the last 3 months.

One thing that was brought out to me by my local banker the other day and I had never thought of this, is that both of my local banks, we have two in my hometown, survived the Depression of the 1930's, but both of them have recently been bought out to meet additional capital requirements because of excessive loan losses.

Senator **Boren**. Both banks?

Mr. **Voth**. Both banks, they survived the thirties, but they did not survive the 1985 crunch.

My question is, of course, what will solve this crisis? Well, first of all, I think, in my opinion, we need to first return profits to the producer. Saving the Farm Credit System and I will also include the banks, because they are going to look at you too, while sacrificing family farms will not work.

That is my opinion.

We need a farm program that injects profitability not one that lowers prices as some are proposing. Credit can only be serviced by profits.

Second, terminate the falling prices in land, by placing these problem loans, possibly in a holding pattern, a holding company, leasing back the land to the farmer, with an option to repurchase at a later date.

Third, and I am not developing a program here, but I am mentioning it as a possibility. Use CCC stocks of grain that are costing approximately $3 billion per year to infuse capital into the agriculture sector or the Farm Credit System. We need to be creative and utilize these CCC stocks, let us just remember they have been paid for once, and the cost continues to mount.

Fourth, initiate a program possibly whereby the Farm Credit System can obtain lower cost of funds, through the issuance of tax-exempt bonds.

Time is running out on both farmers and lenders in our area, we are very concerned. And you know, I think that the word that I want to say is, action must take place very soon. I am not too optimistic. I am a naturally optimistic person, but right now, I really have to say that I am not too optimistic. It seems to me like those in government seem to react to crisis more than meeting the needs of the future.

Senator **Boren**. I am afraid you are right.

I am afraid that is a fair indictment of the way that the system operates.

Mr. VOTH. My suggestion is that we need to act creatively, compassionately, fairly, and quickly but let us save our country's greatest industry—agriculture.

I appreciate the opportunity to appear here today.

Senator BOREN. Thank you very much.

I am going to ask Jim Billington to go ahead and then Senator Zorinsky and I can ask questions.

STATEMENT OF JIM BILLINGTON, FORMER PRESIDENT, WOODWARD PRODUCTION CREDIT ASSOCIATION, ALTUS, OK

Mr. BILLINGTON. I certainly appreciate you inviting me here, Senator Boren, and Senator Zorinsky.

We are kind of singing to the choir here, and you fellows have heard a lot of horror stories, recently, I am sure.

I think that there is really two important things that we have on the table that needs prompt attention. I certainly realize that you two people are trying to have that occur, but we do need the Senate farm bill passed and——

Senator BOREN. Jim, I was going to say also, if you want to summarize your statement, we will make sure that we put your full statement in the record.

Mr. BILLINGTON. Yes, I just want to highlight it.[1]

We do need the farm bill passed. We need the Senate bill passed as quickly as possible. I think that the Senate bill that we had last week, is probably very acceptable. I saw the Dole proposal, we looked at it and I do not think that it is as a good a bill as what we had prior to this time, but apparently it might be a budget problem, so we would like to have that bill passed as quickly as possible. Last year at this time, you know, there were some advance payments made, and the credit institutions last year, were used to getting, in some case $25,000 in my case, of payment money that could be utilized in how to reduce debt, at the present time, it would help.

There is nothing happening now, because there is no law in effect, for next year, so it is becoming very, very important, particularly to people who might be cattlemen or someone who renew loans in the fall and winter, that they have a farm bill so that they will have something and the banker will have something to hang his hat on.

We have criticized the Farm Credit System. It is subject to criticism, but it is the most necessary thing that we have in agriculture. It is so, so important. I do not borrow money from there. I used to. I used to borrow money from them and I was very pleased with the relationship that I had with the Production Credit Association where I did business, and I was extremely pleased with the Federal land bank, where I did business.

In 1978, I believe that was the year, I bought additional land and I needed to acquire additional funds, and I went to the Federal land bank and I found out that they were going to put me on an escalating rate. So, I chose to borrow that money elsewhere and then I paid off my other Federal land bank loan, at a later date.

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[1] See p. 425, for the prepared statement of Mr. Billington.

This system, to tell you—my success today, has depended on me and the help that I received from the agencies that we have in this country. The success that I have enjoyed has been essentially related to me and my family.

The institutional help and the luck that I have of operating in this great economy. But now, my success does not depend on me anymore. It depends on what happens to my neighbors. I have lost total, total, control of my activities because my collateral—I am like Ron, I am going to renew a note in January and I do business at the local bank and I do know that the Comptroller of the Currency has just audited that bank and they have some problems.

I am in a position, I think, to pay off my operating debt, this year, by the sale of my stock or cattle which I will sell in January, before that note is renewable. I think that I can pay this off. If I don't, I have got some cows, but I am going to pay it, because I do not want Jim Billington's loan to be classified by the Comptroller of the Currency because once you get into a classified status, that alerts them.

So, I will even reduce my capital cow herd in order to pay that operating debt this year, because that is the only liquid asset that I really have is this.

You know cattle are one thing, and hogs, you may be losing money when you sell them, maybe you are not making a profit, but they are liquid. I cannot sell the farm now, I do not think, I do not believe that I could sell one of my farms at the present time.

And land, we have got a situation now, where the older retired people, this is not just hurting farmers, this is hurting all of our rural economies, as Ron so aptly stated in his statement about what has happened to Main Street. If you have been to Frederick, OK, Senator, and I think that you have, you know the disaster there in that rural community that had three bad crop years in a row. You know these stories are abounding.

Try to help the Farm Credit System solve this problem. But do not let them operate this System in the self-destructive mode that they are now in. They are self-destructing from the top down and the reason that I say this is that I have been an examiner, and I have managed the Production Credit Association for 8 years, and I do know something about the System. I have a lot of friends who are presently operating the System. They are people who I talk to and visit with and I have never seen a staff or a group of employees so demoralized as the people who work for Farm Credit.

Let me give you an example of what has happened. I think that Kelly, you have all of these figures and you are very astute and you know the problem, but just let me bring this to your attention.

In the Wichita district, Senator Zorinsky, we had, in 1975, when I left, I think that there was 265 employees in the total system. At that time, we had 265 employees and today, we have 1,280. The expenses have tripled, more than tripled, they have—this thing is on a self-destruct mode. I had the opportunity here, today, in our audience this morning, one of the Federal Farm Credit board members was here, and I talked to him about this problem. He says, we forced them to raise those salaries, and we forced them to do that. We want them to have good salaries. They forced the Omaha district to raise those wages 5 percent.

The Federal Farm Credit District Board forced them to do it, he said, I am responsible for that. He told me that this morning, Senator, right here. So, you see this System is not working and the expression that we have from this group of 100 that run this System, that definitely, I think that you should take real seriously, because that is very true.

I was pleased also to hear the fellows from Alabama who were able through their own directorship to accomplish the goals that they had.

But you need farmer input and you need those association people who are out in the country, when you rewrite the farm credit assistance, please include those people. Do not get their renowned experts—those people are too far removed from the System.

You know, the farmers were going broke, and their base was eroding and they spent $5 million coming up with that little green pin that they got in their new logo, and they spent thousands and thousands of dollars in designing—well, they were planning on how they were going to become a national bank holding company while the System was crashing and burning.

So, these are the kinds of things. I have a statement here to make and I would also like to say, and maybe this might not be acceptable, but yesterday we testified over in the House and I represent the National Association of Wheatgrowers, with the Corngrowers Association, the Planting Council, the National Cattlemen's Association, the National Grain, and the National Woolgrowers' Association and we definitely have all gotten together and we have an agreed upon policy on how to look at this Farm Credit System.

Now, this is not our final draft. This was before the testimony yesterday in the Senate and the House, so we would like you to look at that.

Senator BOREN. I would like to include that without objection, both your full statement and the joint statement from those organizations.[1]

I also want to ask—I had field hearings in Oklahoma City, earlier this year, and if there is no objection, I would like to ask consent that testimony given in those Oklahoma City hearings also be submitted for the record.[2]

I appreciate the comments that you made very much.

I want to get that figure again, to make sure that we have it for the record. What year was it that you said that the Wichita district had 200 and some employees?

Mr. BILLINGTON. I am doing this by memory. I attended a meeting shortly before I moved into a private banking system.

Senator BOREN. And that was back in 1970——

Mr. BILLINGTON. It was 1975, and I believe that it was 265.

Senator BOREN. So in 1975, they had approximately 265 employees in that district and now, the figure is over 1,200?

Mr. BILLINGTON. Yes, sir, but I do not think that they have as many of the loan numbers as they had then.

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[1] See p. 426 for the joint statements of the several organizations.

[2] See pp. 334–353 for the material referred to by Senator Boren.

Senator **Boren**. We also have seen the figures and the operating expenses have far more than doubled during that same period of time.

Do you have the operating figures there, how much they have escalated?

Mr. **Billington**. Yes, sir.

We have the whole district—I have the information here, and your staff helped me get this information.

They have escalated dramatically.

On the second page, the cost escalation by units of the System.

Senator **Boren**. Yes, for example, the operating expenses for the district of Wichita, have gone from—this is the district operating expenses, it is not the local operating expenses—but they have gone from $13.5 million in 1979 to $25.8 million in 1984. A tremendous escalation.

The FICB of Witchita operating expenses have gone from $3.2 million in 1979 to $8.2 million in 1984. So it is a tremendous increase in the operating and I see here, the number of employees, 1985 was 1,299. It is almost 1,300 and the salary ranges, I would like to ask this question and then yield to Senator Zorinsky.

Yesterday, and it is a scandal to me, we raised the question about the salary ranges for CEO salary ranges at the various district banks, and there was testimony that that range in 1980, was $75,000 to $120,000. And that in 1985, that range is now $146,000 to $233,500 a year.

I would just ask both of you to comment on this, if we do, and I think that I certainly realize and I know that Senator Zorinsky has been one of the most supportive members of the Agriculture Committee, he is the ranking minority member on this committee, strongest supporters of the System that would provide the farmer with credit at reasonable rates, if we are to take action by guaranteeing bonds, or setting up some sort of a holding mechanism where the loans that are not now serviceable can be warehoused for a period of time, in order to prevent foreclosures, would you think it fair for this committee to consider putting conditions on the Farm Credit System to make sure—would ask your reaction on three points:

One, that the number of employees, salary ranges and operating expenses have to be held within reasonable ranges;

Two, that if we are going to provide additional capital to them either directly or indirectly, that they adopt a policy of not escalating the interest rates on loans where you have a family farmer under stress, further adding to his problems; and

Three, that we slow down the total move toward consolidation and the loss of local grassroots control.

Are those reasonable requests in the minds of both of you that we should make of the Farm Credit System if we are to infuse significant amounts of taxpayers' money into the System?

Mr. **Voth**. I think in my mind, you have some reasonable requirements. We know that these are part of the problem that the reason we have gotten to where we are is that the System has become a System that is run mostly from the top down rather than from the bottom up.

Senator **Boren**. Yes.

Mr. VOTH. And that will be self-destructive if we continue that way, even if you would make the changes that you are talking about, it would continue to be self-destructive if we continue with these kinds of policies.

I might say also, one thing that is happening that will continue to happen in our local banks. Whether you deal with short-term credit with a bank or a PCA, they are looking now at these land loans and saying, we have been lending you the short-term money to make those land payments, but no longer are we going to do it because you dont' have any equity left in that land anyway.

In my association in Oklahoma 2 weeks ago, I visited there, and there was not hardly a week a borrower did not come in and say, I cannot make my payments, here is the abstracts, and I am just going to make you a deed. I am just going to give them back to you.

And he told me that most of these people had not ever missed a payment and had never been a day late. Because the local bank and they are strapped, they are saying, hey, we can no longer make payment.

Senator BOREN. So there has to be some mechanism set in place that allows either an interest rate buy-down program or something else, but which the commercial bank can qualify as well, as say, the PCA, that will enable that to continue because it has—what you are saying is that the inability to provide short-term credit is also further undermining the land values because they cannot get the short-term credit, those farmers are not able to make the land payment on time?

Mr. VOTH. That is right.

Senator BOREN. Jim, would you comment on the three points?

Mr. BILLINGTON. I will comment on the three points.

On the interest rate differential, I think that is unconscionable. I think that the gentleman from Louisiana stated it very aptly that this is a brother's keeper system and I think it was unconscionable that you would charge a higher interest rate to the lower quality loans. You work those loans out, that is what those people are in those associations and are paid to do.

They really contribute to them getting there, or there is a disaster or there is some kind of a problem, because there is never been a loan entered on the books of the Production Credit Association, the day that it is entered, it is a good loan. They do not make bad loans, they make good loans.

The day that they are in there, then it is the responsibility of that management and that board to see that that loan quality is maintained and they contribute in many cases, to those loans becoming problems. So that it is unconscionable to let those borrowers out there, who own that System to pay for the mistakes of the management of the System.

That is one point.

And incidentally, let me tell you of an experience that we had. The reason that this is in there, is because of a misunderstood statement that I was a party to. The Wheatgrowers met with Governor Wilkinson and in a meeting, in March 1984, at which time, I asked him the question, what are you prepared to do? And remember this is March 1984—Do you have a plan, contingency plan to have Federal infusion of capital into this System when you have to have additional capital to keep this thing afloat?

And he became very angry and he said, we do not need this. We are a private agency and we are never in this problem.

One of the people there, that day, who was a big borrower, stated that it would sure be nice if you had some way where you could charge me a lesser interest rate, and he is a rich farmer. I should have stopped there, and got that talk stopped, but the Governor said, that sounds like a good idea, that is something that we could run with and the meeting adjourned before we could even address the issue, and the first thing I know, it is policy.

And boy, that is how fast that happened. That did not come from the grassroots. The way the policy works, I will not address that issue. I think that this is some control that should be exercised.

Senator BOREN. Right.

Mr. BILLINGTON. The 1971 farm act was a work of art. Ed Shanky, who is a very astute gentleman put together a group and he definitely had great leadership. Of that law, some of the things that are in that law, are part of the weaknesses now that Ed did not foresee. He had greater trust in people than maybe we should have but part of that weakness is, that the FCA has to approve all of the policies.

But part of that weakness is, that the FCA has to approve all the policies. If you let me approve the policies of the financial system I can assure you that we can control the system.

Now, it says that the policies have to be adopted here, there and there. I do not think that the FCA should be adopting the policies. I think that it should be a joint agreement between the FICB's and the local institution.

About merger? There are some savings to be had by some reasonable amount of looking at your structure. That has always been true. It is like my farm. I mean, I cannot operate the same acreage that I did 10 years ago and survive. I cannot operate the same acreage I did 15 years ago and survive. But the more I have got now, the worse off I am because I am losing money on everything. That is not a good example, but things get larger for efficiency purposes, economies of scale in managing credit institutions because you have so much fixed and overhead costs in certain operations.

But do not forget that the further away from the borrower that this System gets, the less loyalty there will be and the less they will become their brother's keeper and become unconscionable bankers you might say.

I have been a banker too, and I was not an unconscionable banker, but I do not mean to be criticizing the banking institution.

The other question, the interest rate in the merger system, I think that the mergers ought to be stopped because they are being coerced into doing it and I was very impressed with that. The Alabama directors did take that thing over and apparently were able to handle it, but this is not the case in our district and it was not the case in Nebraska, as I understand it. It is not the case in Omaha. They were coerced into doing it and they had to hire a lawyer and get a judge out in this association in Idaho, I believe it was, that failed to approve the merger. They had to get a judge's injunction against that group. They were going to put a PCA across the street from the PCA that voted not to merge. They said, you merge, or we are going to put one across the street from you. So they hired a judge, and they had to go to court and they held it so that they could not put one in and compete with them. He did give them franchise for that territory.

So these kinds of things are going on and the Texas people, this proposal, I think, warrants, I really think that that warrants a lot of study because I heard the man make the testimony and I would like to have a copy of that because I think that he has some grand ideas.

I think that he is absolutely correct and this is probably what is wrong with the cooperative system in our country, is that you have a local cooperative who has a board of directors, that is great, you can handle that. But then that local cooperative board decides that they need another service institution above and beyond them, and then that board of directors themselves, then hires another set of management that is not directly related to the producer out there, to the local people.

This is what is happening to people in Farm Credit, because that district board is answerable, there is only—there are seven members of these district boards, and one of them is appointed by the Governor and that makes you six.

Now, two of those are PCA and two of them are Federal land bank and two of them are bank co-ops. Understandably, those two PCA guys, that are on that district board, their loans have to be processed in the District Bank of Wichita. And those loans are then sent to the FCA for approval.

If the Governor wants the district director to do something, there is always that veiled threat there. I think that this should be taken out of the System, because I do not think, and I do know of cases, where overzealous management has coerced people into making actions with which they definitely did not ever believe.

I do know also that in their request, they requested that they not be given authority to grant salary approval. They do not want that any more. They know that this is a hot potato and they do not want that because they know that this has gotten them into a lot of problems.

They want to give away a lot of things that they do not need.

Senator BOREN. I want to ask Senator Zorinsky if he might agree to recessing briefly since we have another vote.

Senator ZORINSKY. In the interest of time, I have a statement which I will submit for the record.[1]

Senator BOREN. Without objection.

Senator ZORINSKY. I would like to compliment you gentlemen for your testimony. Certainly, it confirms a lot of the previous testimony and it establishes a record that we will take account of when we act on any legislation.

I want to thank you for your efforts.

Senator BOREN. Thank you very much, Senator Zorinsky.

Let me ask one last question and we will close with this and then I will have to go to the floor to vote also.

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[1] See p. 330 for the prepared statement of Senator Zorinsky.

There have been proposals as the farm bill is now before us, to reduce the income level to the farmer rather out of this bill. To cut it back, particularly, by deescalating the target prices, and the income structure for the outyears. There are proposals, for example, to drop the target prices 5 percent a year, for the next 3 years after the first year.

What kind of message do you think that kind of outyear reduction in target prices and in the income maintenance program would send, particularly to the credit institutions, the Credit System, and what kind of impact would it have on the agricultural sector if we were to adopt a program that had reduced target prices and reduced income levels in the outyears?

Mr. BILLINGTON. It would send a message to me, and I have been a banker, and I think that I would say that we have got two choices.

It is going to get worse or we are going to relegislate every year. And that has happened. The first year of this program, they might go for hoping that we could relegislate later. It was the only thing. You know, that you have got a carrot and it is just a little carrot, maybe this year, see, they are trying to give us a little bit more.

But next year and in the outyears, and I am seeing that there is also a little bit of a problem with this target class concept, they are going, are they really going to call it target class? Or are they going to call it market something? And this to me is something, they are getting away from the income support mechanism.

Senator BOREN. If you had a retreat from the idea of income security, especially in the outyear, I would assume that would send a very negative message.

Mr. BILLINGTON. It would send a very negative message, yes, sir.

Senator BOREN. Well, I thank both of you for being here, and I think that your testimony has been very helpful and I know that the other members of the committee are going to read it with interest. I am very proud that we received such excellent testimony from two Oklahomans.

Mr. VOTH. Thank you, sir.

Mr. BILLINGTON. Thank you, sir.

Senator BOREN. We will conclude the hearing at this point.

[Whereupon, at 1:20 p.m., the committee adjourned, subject to call of the Chair.]

APPENDIX

OCTOBER 31, 1985 HEARING

NEWS RELEASE FROM HON. BOB DOLE
A U.S. SENATOR FROM KANSAS

Kansas Senator Bob Dole, Senior Republican on the Senate Agriculture Committee, today underscored the seriousness of the ailing Farm Credit System (FCS), but cautioned against a quick bailout that could roadblock his top priority--to help the American farmer first.

Dole made the statement during today's Senate hearing on the teetering Credit System. The Kansas Senator requested Committee Chairman Jesse Helms (R-NC) to hold these special hearings in view of the deteriorating financial conditions in the farm belt.

"There is no doubt that member institutions of the Farm Credit System are experiencing serious difficulties. However, we must not lose sight of the fact that these institutional problems are based on the financial straits of thousands of U.S. farmers and ranchers. And with the gloomy outlook for recovery of farm commodity and land prices in the next few years, our efforts must focus on saving farm families--not just their lenders," Dole said.

While the Senate is debating a new farm bill, Dole said it would be a mistake to attach a Farm Credit System rescue plan to the pending legislation. "My wheat farmers in Kansas have once again planted next year's crop with no clear idea of what the key provisions of the new programs will be. With the difficulties now facing our efforts to bring the Senate bill within the guidelines of the budget resolution, I would not want to further complicate the matter by introducing new cost factors into the bill," Dole said.

"Before we simply wade into the Farm Credit issue and start tossing money at the problem, we need to determine how the relationships between System member institutions, and between the System and the Farm Credit Administration (FCA), permitted the erosion of its financial base and capital structure. It is clear that, as a prerequisite to any federal assistance, both the FCA and the FCS are going to face some intense scrutiny and possible requirements for changes," Dole said.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM ILLINOIS

Mr. Chairman, I appreciate the opportunity to speak here this morning at the Senate Agriculture Committee's first hearing on farm credit.

Farm credit is one of the most important issues which will face the United States Senate this year. This Committee has worked long and hard to put together a farm bill which will protect our agricultural sector. One of the most vital elements of preserving both the family farm and rural communities is to assure the farmer an adequate income. If the farmer can make a profit, then the farm credit crisis will begin to resolve itself. If the farmer is making money, then he can pay his bills, pay his interest, and pay the principal on his debt.

As the only member of the Senate to serve jointly on the Agriculture and Banking Committees, I am very much aware that we must keep in mind both commercial banks and the Farm Credit System as we address this problem.

I have already introduced S. 1151, the Farm Credit Relief Act, which I feel accommodates both the farmer and the Agricultural bank in terms of dealing with problem loans. My bill deals with only one aspect of the Farm Credit crisis. These hearings will deal more specifically with the situation relating to the Farm Credit System, which is obviously the other key factor in assuring the survival of the family farm.

It is my hope and expectation that we can come to a swift resolution of the problem.

[The following material was submitted by Senator Hawkins]

REMARKS OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION, AT FARM CREDIT LUNCHEON, NATIONAL INSTITUTE OF COOPERATIVE EDUCATION, MANHATTAN, KANSAS AUGUST 1, 1985

I don't have to tell you we meet here at a time of great challenge: challenge for agriculture, challenge for cooperatives, and challenge for the Farm Credit System.

As we face those challenges, it should now be apparent that the leadership in agriculture, in its cooperatives, and in its credit institutions can no longer keep their concerns in their board rooms and out of the news rooms. The plight of agriculture has become the six o'clock news and the morning edition.

And as it is reported, one thing has become increasingly clear. Agricultural lenders in general and the Farm Credit System in particular have become the scapegoats for Government agricultural programs that have failed.

So let's set the record straight.

There isn't a farm credit crisis in rural America; there is a farm income crisis.

High interest rates aren't bleeding farmers to death; low income is.

If anyone doesn't believe that, I suggest they take a farmer's operating statement and do two things. First, lower interest charges by 20 percent and see how that changes the bottom line. Second, with the original interest charges restored, raise the price received for the product 20 percent and see how that affects the bottom line. I guarantee you'll see an improved operation.

And the same problem is affecting the institutions of the Farm Credit System.

In most cases:

it isn't bad management by farmers;
it isn't poor judgement by lenders;
it isn't inadequate supervision by regulators;
and it's not even adverse weather.

It's LOW FARM INCOME.

Let me turn now to the situation in the Farm Credit System and how the income problem has affected its institutions. I am sure many of you have read or listened to reports that the system is on the verge of collapse or that it needs an immediate infusion of Government capital.

My answers to those allegations are that it isn't and it doesn't.

From a realistic standpoint, I don't think it would be appropriate to ask the Congress or the Administration for any kind of financial assistance unless and until the system has done everything in its own power to alleviate its problems.

But let's look at some numbers to get a handle on the extent of the problem; first non-performing loans and, second, charge-offs.

For the sake of definition, a non-performing loan ranges from one that is severely delinquent to one that is in such bad shape it is no longer accruing interest on the books of the institution. A charge-off, as the term suggests, is a loan that has been written off as a loss.

As of March 31, 89.8 percent of all Federal Land Bank loans were performing. Their non-performing loans totaled $5.3 billion, about 10 percent of the total outstanding. Their non-accrual loans totaled $1.3 billion, about 2 1/2 percent of outstandings.

For Production Credit Associations, 84.3 percent of outstanding principal was classed performing. Non-performing loans totaled about $2.7 billion, of which $663 million were non-accruals.

Reports from the Federal Intermediate Credit Banks--from whom PCAs obtain their loan funds--indicate 85.3 percent of total volume was performing. Their non-performing loans totaled $2.3 billion, $247 million of which were in non-accrual status. Non-accruals here were 1.5 percent of the total.

For the Banks for Cooperatives, 88.7 percent of total volume was performing, with only $13.9 million in non-accruals.

During the first quarter of 1985, the Federal Land Banks charged off $40.7 million in loans, PCAs $19.2 million, FICBs, $1.2 million, and the Banks for Cooperatives only $33,000.

Despite these problems--and this is important--the 37 Farm Credit Banks posted net earnings of $90.5 million for the first quarter of 1985.

And, at the end of 1984, the system's 37 banks had $5.1 billion in capital stock and its PCAs had $1.9 billion. Earned net worth totaled $4.1 billion for the banks and $2.5 billion for the Federal Land Bank Associations and PCAs . Overall reserves for possible loan losses totaled $1.3 billion.

I want to make this point as strongly as I can because there is substantial misunderstanding regarding the problems the system is facing.

There is no question that it does have some credit problems. But it does not have a problem with capital adequacy. At this time, it does not require an infusion of capital, from the Government or anywhere else.

The system's problems are really three-fold.

First, capital and capital management (the accumulation and use of capital) is disbursed.

Second, with the disbursed capital management, level of loan losses, and the build-up of non-earning assets, how does the system generate enough earnings to maintain the confidence of the investor's who buy its securities?

And, finally, self-help by the system requires decisions by 13 separate boards of directors. This risks an adverse decision by a minority and is entirely too time consuming.

Efforts to solve these problems evolve around a word most fitting at this meeting. That word is "cooperation."

To help solve the first problem, capital should be consolidated in those districts where PCAs are experiencing severe financial difficulties and must be consolidated in those districts that have any prospect of requiring financial assistance.

If the financial assistance programs aren't approved, or if conditions places upon the programs, such as consolidation, aren't accepted by the district involved, the options are the liquidation of associations or even of a Farm Credit Bank.

The former could result in problems for borrowers, and the latter would cause serious disruptions in the bond market.

The earnings problem must also be addressed. The purchase of non-performing assets by the Farm Credit Capital Corporation will help individual institutions. But remember that the money is coming from other institutions and could diminish their earnings.

Earnings are essential to maintain investor confidence and to avoid paying a "risk penalty" on securities, which would undoubtedly cost borrowers mere over the long term.

One way to ensure the earnings from loans that are performing will is to adopt differential interest rates.

The last problem needs to be addressed by the system through its new Farm Credit Corporation of America. In addition to administering loss sharing agreements among Farm Credit Banks, it should oversee system capital management, set and enforce financial and credit standards, and coordinate national programs.

Unless things continue to deteriorate, I still believe the Farm Credit System has the human and financial resources to deal with its own problems. It simply has to make use of those resources in a systemwide, cooperative effort.

The evidence to date is that it is doing just that.

REMARKS OF DONALD E. WILKINSON, GOVERNOR, FARM CREDIT ADMINISTRATION, AT NEWS CONFERENCE--SEPTEMBER 5, 1985

We are here today to discuss actions taken yesterday by the Federal Farm Credit Board in response to the credit crisis being experienced by the institutions of the Farm Credit System and other agricultural lenders.

I want to remind you that the Federal Farm Credit Board, though composed of farmers, ranchers, and leaders of agricultural cooperatives, is a part of the Farm Credit Administration, the Federal regulatory agency. We do not represent the Farm Credit System. Our role and relationship is more like that of the Comptroller of the Currency and the national banks it regulates.

So as the Federal regulator, our concern is with the safety and soundness of the institutions we regulate, the protection of those who invest in the securities sold to raise loan funds, and with the credit worthy borrowers who depend on the system as a source of reliable credit.

For some time, we have maintained that the system has the resources to take care of its own problems. But we put two caveats on that statement.

One was the system's ability and willingness to quickly consolidate its capital. The other was that the agricultural economy would not continue to deteriorate.

Recent projections have caused us to modify our position.

System earnings for the second quarter of 1985 declined dramatically. Losses projected for the Federal Land Banks will result in a 1985 operating loss for the system as a whole.

Crop reports by the U.S. Department of Agriculture show that substantial increases in farm production and reduced farm exports will further deteriorate commodity prices, resulting in questionable debt repayment ability and even lower collateral values, especially land.

These factors point to a continuing weakness in agricultural income and additional financial restructuring in the farm sector.

All of this leads us to believe that the Farm Credit System is rapidly approaching the time when it will require Federal financial assistance unless major new forces alter these trends. Failing that, we expect assistance will be needed in 18 to 24 months.

Yesterday, the Federal Farm Credit board took two actions that bear on these problems.

First, it approved regulations on an expedited basis that implement FCA's statutory authority to mandate loss sharing between and among system institutions.

Negotiation of voluntary loss sharing agreements is simply too time consuming and costly. And the threat always exists that some institutions may balk at approving them. The regulations will ensure that system resources are brought to bear quickly and effectively to meet system obligations to investors and borrowers when and if needed.

We also felt this authority is necessary because it would be inappropriate for seek Federal assistance until the system has made maximum use of its own resources.

Second, the board directed the agency to begin discussions with the Congress and the Administration to enact enhanced regulatory authorities for FCA and to establish a plan for Federal assistance to the system.

In order to be a more effective regulator, FCA needs the same enforcement authorities as are held by other Federal financial regulators if it is to protect the safety and soundness of system institutions. These include the power to issue cease and desist orders, to levy civil money penalties, and to remove officers and directors of system institutions. Any of these actions, of course, would be subject to judicial review.

As for Federal assistance, several alternatives need to be explored. It is important and prudent that such mechanisms be in place soon on a contingency basis so that aid could be provided before irreparable damage is done to the credit delivery system.

These alternatives include:

Use of a Government guaranteed security or a guarantee on individual farm loans.

Creation of a new organization or expansion of an existing mechanism to acquire non-performing real of financial assets to stabilize the decline in collateral values and to relieve financial institutions of non-accrual loans.

A direct infusion of Government capital into the system.

A buydown of interest rates.

FCA staff will be exploring these and other alternatives with the Administration, the Congress, and representatives of other agricultural lenders over the coming weeks as we all seek to deal with a situation having grave effects on farmers and lenders.

Now, we'll be pleased to respond to your questions.

[Reprint from the Wall Street Journal, September 4, 1985]

OUT OF OPTIONS--FARM CREDIT SYSTEM, BURIED IN BAD LOANS, SEEKS BIG U.S. BAILOUT

Aid Could Add to the Deficit, Hurt Free-Market Goals; But Some Help Is Likely

(By Charles F. McCoy, Staff Reporter of The Wall Street Journal)

Time is running out for the Federal Farm Credit System, and the nation's largest single holder of farm debt is seeking some form of federal support for its $74 billion loan portfolio.

Although the exact form of the system's bailout proposal hasn't been determined, such an operation would surely dwarf the record $4.5 billion rescue last year of Continental Illinois Corp. The big Chicago bank had only $40 billion of assets and a diversified loan portfolio that farm economists say was healthier than the Farm Credit System's.

And although no one knows the amount of federal money that may be needed, the Farm Credit System's reach for a federal lifeline has broad implications for public policy: It could well plow under President Reagan's efforts to push American agriculture into a freer market, and it would make more difficult his drive to reduce the $200 billion federal budget deficits.

"In scope and in terms of implications for government policy, this is far and away the biggest financial blowup since the Depression," says John Urbanchuk, an economist at Wharton Econometrics Forecasting Associates in Philadelphia.

Staggering Problems

The system's problems are staggering. Barring a miraculous rebound in farm income, as much as 15 percent of its $74 billion in loans-a huge $11.1 billion- is uncollectable, system sources say. And many farm economists term that estimate conservative.

Moreover, at least nine of the system's 37 main banks have more problem loans than capital-a harbinger of failure. The system consists of 12 regional banks, each of which has three lending arms: a land bank for farm-land loans; an intermediate credit bank for short-term production loans, and a bank for farm cooperatives. There also is a central bank for farm co-ops.

And the system has projected a third-quarter loss that some of its bankers say will exceed $70 million. Yesterday, the system predicted its first since it was created during the Depression, and the prospect makes its many bondholders uneasy. The system raises money be selling bonds to investors. Last year, the system earned $440 million.

A Plea for Help

Faced with these problems Donald Wilkinson, the governor of the Farm Credit Administration, a federal agency charged with regulating the system, has advised congressional leaders and administration officials that the system can't survive its snowballing credit problems without some form of direct federal support.

Whipsawed by the faltering farm economy, the system has been racing for weeks to rein in its mounting credit problems. Now, that race appears to be lost.

In an interview yesterday, Mr. Wilkinson said the farmers' troubles have outflanked the system's worst-case projections and left it foundering in billion of dollars of loans that are either uncollectable or will be within months. "We've come to realize that the deterioration in agriculture has grown beyond the ability of [the Farm Credit System] to handle it," Mr. Wilkinson said. "We cannot absorb the losses we face."

His comments marked a stunning reversal of his position only a few weeks ago, when he adamantly insisted that the system isn't broke and doesn't need a bailout. They also signal the failure of the system's belated, often ill-conceived efforts to pull itself out of the unparalleled morass of bad loans and lax procedures.

Interim help could come from the Federal Reserve System, which is already empowered to act as the lender of last resort. Led Chairman Paul Volcker has said the central bank stands ready to help the Farm Credit System should it be unable to meet its financing needs in the marketplace. The Senate also has passed a resolution in favor of aiding the system.

For the longer run, the Farm Credit System hopes to forge a sort of lenders' cartel with commercial banks that would make the government liable for practically all of the nation's $210 billion farm debt. In addition to the system's $74 billion portfolio, commercial banks hold $51 billion of farm debt, the Farmers Home Administration (the Agriculture Department's direct-lending arm) is owed about $25 billion, and the rest of the debt is scattered among finance companies, insurers and a slew of other federal agencies such as the Commodity Credit Corp.

The notion of a lenders' cartel appeals to the Farm Credit System partly because it believes that it can't be saved without government measures to stem agriculture's wrenching decline and that in needs help from commercial banking's powerful Washington lobby to get them. And part of the reason is more basic. "We can't realistically hold out our hats and expect everybody else who has ag loans to stand alone," one system banker says. "We'd be crucified."

The system is known to be considering at least three basic approaches: The formation of a government-financed warehouse to lift farm assets-loans, land and farm machinery-our of all farm lenders' portfolios; continued and perhaps increased price supports; and a direct infusion of government capital. All three would be followed by a dramatic restructuring that would aim to prevent a similar squeeze from recurring, either by establishing an insurance fund similar to the Federal Deposit Insurance fund similar to the Federal Deposit Insurance Corp. fund for commercial banks or by allowing the system to diversify its asset base beyond agriculture.

"We may need to do some or all of those things," Mr. Wilkinson said.

But as of now, the administration doesn't favor any plan for government-backed "warehousing" of bad farm loans or an infusion of federal money, says Frank Naylor, a deputy under secretary of agriculture. He added that the administration isn't inclined to "charge in" until the Farm Credit System has had a chance to solve its problems on its own. Mr. Naylor adds that he hasn't heard from Mr. Wilkinson or the system that the lending network now needs a government bailout.

With a similar reaction to Mr. Naylor's, George Dunlop, staff chief for the Senate Agriculture Committee, said that before considering a bailout, Congress would insist that the Farm Credit Administration fully use its existing resources. No one, he added, has suggested that the system is "anywhere near" doing so.

However, a staff aide for the House Agriculture Committee said he was called by a Farm Credit Administration lobbyist yesterday and informed that the agency has decided to concede that farm financial conditions have so deteriorated that federal aid is required. The committee staffer predicted that the first reaction of farm-state lawmakers will be relief that the agency has "finally laid the cards on the table." He said Congress will be "very willing to explore the problem and to support some kind of legislative remedy."

Regardless of the form of the bailout, the system's problems threaten many. Among those who may be hurt are institutional investors, such as bank trust departments, insurance companies and pension funds, which hold $70 billion of the bonds that the system sells to finance its loans. These investors face the possibility that the now-liquid market for the notes many dry up.

In addition, thousands of farmers, who under the system's rules had to buy stock in the lending unit in an amount equal to 5 percent to 10 percent of the loan, could see that investment washed away. And taxpayers could be stuck with the eventual tab.

But the elements of a long-term bailout won't come together easily. Congressional cross-tides, a budget-conscious president and the system's own cumbersome bureaucracy will make moving quickly almost impossible. "It's one thing for the head of the Federal Reserve to say we'll stand behind $74 billion, but will he have the guts to do it when push comes to shove?" Wharton's Mr. Urbanchuk asks. "I'm afraid we'll see a bubble-gum-and-baling-wire approach that will merely delay the day of reckoning."

That, however, seems to have long been the system's own approach to solving problems. The system fulfilled its intended role of primary lender to American agriculture beautifully for decades. In many years, its loan losses were virtually zero. "We just rolled along," says Burgee Amdahl, the head of the system's biggest bank, the $12 billion Farm Credit Bank of St. Paul. "It was dreamland."

Unwieldy Structure

That seductively easy living masked a structure that was growing dangerously unwieldy. The 37 primary banks have hundreds of local lending outlets run by local boards that are elected by area farmers. The boards zealously guard their local control, and the system has come to resemble "a bunch of unruly duchies with no central guidance," one former system banker says. "The structure is an anachronism that has defied quick action. Turning this thing around is like trying to turn a battleship around."

The diffuse construction of the system would make supervising it difficult under the best of circumstances. But now it is becoming clear that the system has hummed along for years with little effective regulation. Astonishingly, the system has never been audited by an outside auditor. It didn't begin tracking quarterly earnings and loan performance until September 1984, after the agricultural economy had turned many of its loans into basket cases. "We fiddled while loans burned," acknowledges a former system banker.

Especially during the go-go 1970's, the system seemed to run wild. Bewitched, as were other lenders, by the prospect of unending inflation, system bankers urged farmers to borrow more, bent rules and cut corners. Loans outstanding zoomed from less than $20 billion in 1972 to $66.2 billion by 1980 and continued to rise even after inflation began to break.

Herbert Ashton, an Indiana fruit farmer, recalls being wined and dined at a local country club by bankers from his local system bank who extolled the virtues of inflation and offered to lend him $1 million on the spot. "I turned it down," he recalls. "But they sounded like a soap testimonial. They were giving money to whoever passed their way, and they didn't ask too many questions."

Bad Lending Practices

The lack of effective regulation let bad lending practices flourish. One former system banker in Iowa, for example, recalls inadequate documentation of collateral that resulted in "bland stares when we went out to check a tractor a fella had put up on a loan. We found out later that he'd never owned it."

Other rules were often fudged. A system stricture against lending other than for agricultural purposes occasionally was ignored; one local bank in Kentucky even financed a Hollywood porno movie. Recalls Ray Powell, a former loan officer in Creston, Iowa: "The fever was on."

When the Farm Credit Administration's examiners did discover problems, it often could do little about them. Unlike commercial-bank regulators, the administration doesn't have the power to issue cease-and-desist orders. Administration officials say that weakness frustrated their efforts to rein in excessive lending.

In 1978, for example, administration examiners warned officers at the Federal Intermediate Credit Bank in Spokane that its loans on fishing boats were badly undercollaterized and should be cleaned up. When the bank's directors ignored the examiners' reports and did nothing, an administration official says, "We wanted to throw out their board, but our hands were tied."

Spokane Bailout

Last February, the Spokane bank became the first intermediate credit bank to require a system-engineered bailout, primarily because of bad fishing-boat loans. In June, the intermediate credit bank in Omaha asked for an even bigger rescue, $435 million.

The system probably could have survived its shortcomings except for the sudden onset of deflation in the farm economy. Land values, the collateral for most farm loans, fell again in the second quarter and in some areas are down to half the boom peaks. Commodity prices, under pressure from a fall harvest that is expected to be huge, are heading lower, cutting farm income. Most farm economists see little hope for improvement for years.

The system has been painfully slow to take full measure of its problems. As late as last year, when the farm slump was hitting hard, a study of the system's condition was speaking of such as "increasing segmentation of the farm economy into a bipolar mode" rather than recommending concrete action.

In an effort to get things under control, the system has hired Price Waterhouse, the Big Eight accounting firm, to conduct an audit this year. A special credit review of the system's land banks, the core of the system with two-thirds of its loans, is turning up huge losses that the system hadn't previously recognized. In the Omaha land bank, for example, the review uncovered $50 million in additional losses that the bank should have allowed for during the first six months; including them would have converted the bank's reported $2.7 million first-half profit into a $47.3 million loss.

The system's sudden acknowledgment of its problems has left farmers stunned and bewildered. Many feel that they have been betrayed. Decisions by many banks to raise interest rates to bolster earnings, for example, have been "a knife in farmers' backs," says Luman Holman, a Jacksonville, Texas, farmer. Some of the most solvent borrowers, such as Scotty Baesler, a Lexington, Ky., farmer, have abandoned the system. "I paid my $200,000 loan from the system and went down the street to the bank," he says. "Raising rates when we're hurting so much is a crime."

The alienation of farmer-borrowers adds to the system's problems. As credit-worthy farmers flee, the system's concentration of troubled customers grows. And because farmers, who technically own the cooperatives, have to vote on any major structural changes, an angry customer base could further slow the system's survival efforts.

"They think they got problems now," says Mr. Ashton, the Indiana fruit farmer. "But farmers are going to make things a lot tougher for them than they ever thought they could get."

[Reprint from the Wall Street Journal, September 4, 1985]

FARM CREDIT BONDS, NOTES ARE SPREAD AMONG INVESTORS--DESPITE SYSTEM'S PROBLEMS, MOST HOLDERS REMAIN UNCONCERNED ON SAFETY

(By Charles F. McCoy, Staff Reporter of The Wall Street Journal)

The $70 billion of Federal Farm Credit System bonds and notes are woven through the fabric of the American financial system.

Some 40 percent of the securities are held by commercial banks, mostly in trust for customers. Some 18 percent are held by foreign investors, with most of the rest sprinkled through pension funds, money management funds and insurance company portfolios. About 4 percent are held by individuals.

Just who holds the securities is difficult to pin down. Prudential Insurance Co. of America says it holds about $28 million of the securities in its own portfolio and in money funds it manages for other investors. Liberty U.S. Government Money Management Trust, a fund made up of primarily government agency debt instruments, held about $750 million of Farm Credit securities as of last year. Mark Gallon, an investment manager there, declines to say how much the trust currently holds, but he says it's "in the same ballpark." Elwood Haake, a vice president at Northern Trust Co., Chicago, says the bank holds "several millions worth" of the securities in its trust department, but declines to be more specific.

Despite the system's problems, most of the investors remain unconcerned about the securities. Historically, Farm Credit paper has been the safest and best of the agency papers, trading at spreads of only two to five basis points above benchmark Treasury bill rates.

Although the securities aren't guaranteed by the government, traders and investors alike operate as if they were. "I don't worry about the notes because the system is big enough that the government will be there if it has troubles," says Northern Trust's Mr. Haake. So unconcerned is he, he says he's never even bothered to read one of the system's annual reports. "That paper is as good as gold."

Not everyone agrees. The spreads on the securities have risen, reflecting market nervousness. Yesterday, the system's six-month notes closed at a yield of 7.86 percent , 21 basis points over the comparable T-bill rate at a yield of 10.07. And some investors have sold the securities. Bob Brenton, chief executive of Brenton Banks Inc., a Des Moines, Iowa, bank holding company, has sold some $40 million of the securities in recent weeks. "We know what the situation on the farm is and we know the system's got problems," he says. Alan Schreiber, a money manager with T. Rowe Price Associates Inc., has weeded about $175 million of the securities out of his portfolios. "I don't want anything to do with them," he says.

[Reprint from The Wall Street Journal, Thursday,
September 5, 1985]

U.S. DOESN'T PLAN DIRECT AID TO FARM CREDIT--REAGAN'S STANCE UNCHANGED, BUT SYSTEM'S PROBLEMS COULD FORCE THE ISSUE

(By Albert R. Karr and Laurie McGinley
Staff Reporters of The Wall Street Journal)

WASHINGTON--The Reagan administration and the Federal Reserve Board don't plan any direct federal assistance for the huge Farm Credit System, and the system took steps yesterday to try to solve internally its problems with a growing portfolio of bad farm loans.

White House officials maintain they don't believe the system needs direct federal aid, because it has internal resources to help solve its own problems. A White House official disclosed that in July, President Reagan accepted the recommendation of an administration working group that said no federal assistance should be provided to the system.

An administration official said that the president's decision is the latest official position by the administration. However, he said that the issue certainly will arise again if it becomes obvious that the financial condition of the Farm Credit System is deteriorating severely.

The Fed, which is empowered to act as the lender of last resort, hasn't received a request for any funds. "We provide liquidity, but they don't need it," said an official of the Fed, which would most likely provide any such loans through the discount window.

Resistance Persists

The government's resistance to direct aid persists despite a warning this week from Donald Wilkinson, governor of the Farm Credit Administration, that the system can't survive its worsening credit problems without some form of direct federal aid. Although the agency regulates the Farm Credit System, the system itself isn't a federal agency and its debt securities aren't guaranteed by the government.

Yesterday, the agency's board empowered Mr. Wilkinson to transfer assets among the system's approximately 800 units in an effort to better absorb loan losses.

The move was taken partly to help cover the losses, and partly to demonstrate to skeptical administration officials and members of Congress that the system is willing to exhaust all internal resources before formally seeking federal assistance. Mr. Wilkinson and others in the agency believe federal aid will be needed, despite the new measure.

Farm Credit sources have said that as much as 15 percent of the system's $74 billion in loans, or $11.1 billion, is uncollectable.

Crop Subsidies

In Congress, lawmakers tussling with a major new farm bill will first try to deal with the Farm Credit System's problems, and those of all farm lenders, by increasing efforts to maintain a high level of crop subsidies, a House Agriculture Committee staff member predicted.

Eventually, if faced with a collapse of the system like the Continental Illinois Corp. crisis that triggered last year's federal rescue of the holding company's bank, Congress would be forced to approve some kind of help, he said. That could include a proposed government-backed corporation that would, in effect, take over problem farm loans from all kinds of farm lenders, and a quick infusion of cash from Congress.

These ideas were among those considered yesterday by the Farm Credit Administration's directors at a meeting that is expected to continue today. The board has scheduled a news conference today concerning those discussions.

Senate Majority Leader Robert Dole (R., Kan.) has been trying to devise a solution to "contain" the system's financial problems, a Dole aide said, or else they'll "grow like topsy."

Attitude in Congress

An aide to one Republican member of the Senate Agriculture Committee held our some hope for congressional action to assist the credit network. If the system "can get its act together," creating greater centralized authority, "Congress would probably be willing to go along" with the agency's proposals for government aid, he said. "If they come well-prepared, I thing they'll get what they want"--but with strings attached, he said.

Although the Reagan administration currently has no-plans to aid the Farm Credit System directly, officials are considering several options for assisting the system if it becomes necessary. But Agriculture Secretary John Block said at a news conference, "We have not settled on any of those." For one thing, the system must learn more about the extent of its own financial problems, he said. While certain points of distress are evident, "we don't know where the whole system stands," Mr. Block said.

His department wants to ensure that any help for the credit system produces "a sound source of credit that's affordable" to farmers, at rates competitive with other lenders, instead of frequently higher loan rates charged by system units, he said.

Emergency Regulation

The emergency regulation giving Mr. Wilkinson new authority on moving assets within the system will take effect as soon as it's published in the Federal Register in a few days, a credit agency spokesman said.

The agency currently has the power to transfer funds within the system. But the agency hasn't used this plan because it can be implemented only when the unit receiving the transfer is on the verge of defaulting on its loans from one of the system's 37 main banks, which may be too late.

The agency has had to labor for special approval from local boards around the country to obtain rescue packages for troubled operations in the system's Spokane, Wash., and Omaha, Beb., districts. The latest bailout, for the Omaha district, took three months to complete.

A new entity, Farm Credit Corp. of America, based in Denver, was recently created, with the aim of empowering that corporation to direct fund transfers within the system. But the corporation won't be able to do so unless the various local boards vote to give it that power.

[Reprint from The New York Times, Thursday, September 5, 1985]

FARM CREDIT AGENCY MAY REQUEST FEDERAL AID AS BAD LOANS PILE UP

(By Peter T. Kilborn, Special to The New York Times)

WASHINGTON, Sept. 4--The Farm Credit Administration, overseer of the nation's farmer-owned banking system, is considering asking the Reagan Administration for a rescue from a pile-up of bad loans, officials of the agency reported today.

The White House, which has been closely watching the deteriorating farm economy all summer, has opposed such assistance on both ideological and budgetary grounds. But loan defaults among farm borrowers have become so widespread that officials may decide to recommend some sort of intervention to President Reagan, according to a White House economic policy official.

"The feeling is we're going to have to do something," said the official, who asked not to be named.

"We don't have all of the options laid out," Agriculture Secretary John R. Block said today at a news conference.

"But we are monitoring the system on a daily basis and acquiring more information on which to base a decision."

The Farm Credit Administration, whose governors gathered today for a special meeting at their McLean, Va., headquarters to study the loan difficulties, oversees the Farm Credit System. It is a network of 12 farm-banking districts with a total of 37 farmer-owned banks.

The banks include three types of lenders, some making short-term planting loans, some making mortgage loans and some making loans to organizations that provide services to farmers. The system raises most of the funds it lends by selling bonds in the financial markets.

Two of the districts, Spokane, Wash., and Omaha, have had to be rescued this year from insolvency by the other districts. And Tuesday the system said that for the first time in at least 40 years, the F.C.A. expects to lose more money from bad loans than it will earn from the interest it collects on loans.

News of the predicted loss and the disclosure in an article in the Wall Street Journal that a request for Federal support was being considered pushed up interest rates on the system's debt by as much as a quarter percentage point in trading today.

The issue has been at the top of the President's economic-policy agenda all summer, along with Mr. Reagan's tax plan and the nation's trade deficit, according to Administration officials.

One reason for Secretary Block's noncommittal public approach today appeared to be a view within the Agriculture Department that the Farm Credit Administration has adequate resources to resolve the issue. "We continue to believe that the system has sufficient loan loss reserves to contain its own problem," said Robert L. Thompson, Assistant Secretary of Agriculture of Economic Affairs.

Of numerous approaches to Federal intervention, officials said, the one mentioned most often would create a federally chartered financial institution to buy the system's troubled loans, most likely for less than their face value. The new agency would then assume ownership of the property covered by the loans, rent it back to the farmers and let them try to purchase it sometime later.

There is wide disagreement within the Administration over a rescue. The idea is opposed by the council of Economic Advisers and the Office of Management and Budget, while the Agriculture Department might favor such assistance if the decline of the farm economy persists.

Administration opponents of a rescue fear its impact on the Federal budget, particularly at a time when Congress is putting together a new four-year farm bill that is likely to exceed the President's objectives by several billion dollars.

Agriculture Department officials said that if the system could not overcome its difficulties by itself it would have to submit to close Government regulation of the sort that the

Federal Deposit Insurance Corporation, the Comptroller of the Currency and the Federal Reserve Board now provide for the nation's commercial banks.

Acceptance of such supervision would mark a significant reversal in the system's jealously guarded independence from Federal regulation.

The farm economy has been deteriorating for four years because of declines in farm exports, in the prices farmers get for their products and in the value of the farm land that farmers use as collateral for their loans.

Farm economists suspect that the deterioration may have accelerated this summer amid projections of bumper harvests that have pushed crop and land prices down still further. In addition, the F.C.A. reports that loan-payment difficulties have spread from short-term planting loans to longer-term farm mortgages.

Farmers owe their creditors $213 billion, and the F.C.A. says $77 billion of that is owed to the Farm Credit System. As of last March, the F.C.A. says, nonperforming loans--those ranging from default and foreclosure to those on which the system has extended repayment schedules--amounted to $11.2 billion, up from $9.1 billion just three months earlier. The F.C.A. says that perhaps half the non-performing loans will have to be written off.

The Administration and the F.C.A. appear to disagree over the level of funds that the agency has available to accommodate such write-offs and avert losses for the system. The F.C.A. says it has about $1.2 billion in loan loss reserves for such purposes, but the Agriculture Department says that from all sources the system could provide $6 billion or $7 billion.

If the Administration were to intervene in the Farm Credit System, Agriculture Department officials said, it would require that those funds be used to reduce the system' losses.

Some officials doubt that assistance will be needed. If intervention is decided upon, however, the Administration is already exploring several forms.

In one case, Assistant Secretary Thompson said, the Administration might ask Congress to create an agency that would buy the system's deteriorated loans and take possession of the farms on which the loans were made. Such an agency, which officials have informally dubbed "Aggie Mae," might finance purchase of the loans through the sale of tax-exempt bonds, Mr. Thompson said.

In the case of farmers who have enough income to keep up with all their other expenses, the agency would rent the farm back to the farmer and in five years give him the first option to repurchase it at the fair market value then prevailing. If he could not do so, the farm would make money or lose it under the arrangement, depending on whether land values rise or fall.

Under another proposal, the Government would create another institution, tentatively called the Agriculture Conservation Corporation, that would buy up farmland. By reducing the supply of land--and, with it, farm production--both farm prices and land values would be expected to rise or at least stabilize.

Sometime later, when values would be stronger, the institution would resell.

[Reprint from the Washington Post, Friday, September 6, 1985]

BILLIONS NEEDED FOR FARM CREDIT

(By Ward Sinclair, Washington Post Staff Writer)

The troubled Farm Credit System, which holds about a third of the nation's agricultural debt, will need "billions of dollars" of federal aid within the next two year because of the slumping farm economy, its chief government overseer said yesterday.

Donald E. Wilkinson, governor of the Farm Credit Administration, the federal regulator of the farmer-owned system, said that his agency will seek now enforcement powers and has already begun discussions on how federal aid might best be provided to keep the FCS solvent.

Wilkinson estimated that any package "will require multibillions of dollars." Any more specific figure would depend on the extent of the deterioration of the farm economy in the following months and the form of the aid package, which Wilkinson said could be anything from federal guarantees to direct subsidies.

The system, which makes loans for farming and for rural housing, was formed as the Federal Land Bank after World War I, and was expanded into its current form during the administration of Franklin D. Roosevelt.

Except for its initial federal seed money, it required no federal help until now, even during the Great Depression. But the deteriorating farm economy and falling land values have let to an increasing number of bad loans and a growing crisis among many of the system's 37 banks.

Although the Reagan administration has insisted that the FCS must exhaust its own resources before seeking government help, federal officials for weeks have been reviewing possible approaches to helping the system.

And farm-state legislators have warned for months that some kind of aid to the huge borrower-owned farm lending system might be required as the farm economy continued to falter and the farm credit crisis intensified. A House Agriculture subcommittee has scheduled hearings for next week.

Until his public statement yesterday, Wilkinson and other FCS officials had maintained that the system, with $74 billion in outstanding debt, was strong enough to deal with its problems--as long as the farm economy did not worsen.

Wilkinson said yesterday that the system remains "very solvent" but that new forecasts of bumper crops, lower prices and fewer exports, along with new FCS losses and continuing land deflation, have dramatically changed the picture. Unless there is a major turnaround, he said, "we expect assistance will be needed in 18 to 24 months."

"Our concern is with the safety and soundness of the institutions we regulate, the protection of those who invest in the securities sold to raise loan funds and with the credit-worthy borrowers who depend on the system as a source of reliable credit," Wilkinson said.

Many of the bonds sold by the FCS to finance its operations are held by banks and institutional investors. Until recent weeks, the FCS bonds, despite growing public awareness of the system's problems, have been marketed without difficulty.

Wilkinson said that if federal contingency aid is not forthcoming, the system would face the possibility of liquidating portions of the FCS, including some of its regional banks that provide land and farm-operating loan money to banks.

Farm Credit has 37 banks in a dozen districts, which obtain funds from the bond sales and then lend the money to the local land banks and production credit associations. The system's most troubled banks tend to be in the export-dependent grain belt of the Midwest and Plains, where land deflation and low prices have put thousands of farmers in economic trouble.

An estimated 15 percent of the FCS's debt is considered uncollectable, with the prospect of that figure rising because of low prices and declining farm sales.

The FCS's troubles have spilled into other farm-lending circles. As the FCS has refused to refinance many of its customers, new pressures have been placed on commercial banks and the Farmers Home Administration (FmHA), the other major agricultural lenders, for operating money.

The decision to seek federal help was make this week by the FCA's policy-making Federal Farm Credit Board, which directed Wilkinson to open talks with Congress and the administration on obtaining new regulatory powers and federal assistance. Possible approaches listed by Wilkinson included government guarantees on securities or individual farm loans, creation of a new organization to take over nonperforming loans and assets to stabilize collateral values, direct federal grants to the FCS or federal subsidization of lower interest rates.

The Farm Credit Board also approved emergency regulations that will allow the FCA to require sharing of losses among the FCS' member institutions, a step that would eliminate time-consuming negotiations now required to effect voluntary loss-sharing.

Within the last year, after considerable controversy, intermediate credit banks in Spokane, Wash., and Omaha have received infusions of capital from the system to cover losses.

[Reprint from The Wall Street Journal, Friday, September 6, 1985]

FARM CREDIT WILL NEED MASSIVE U.S. AID IN 18 TO 24 MONTHS, CHIEF REGULATOR SAYS

(By Albert R. Karr and Charles F. McCoy
Staff Reporters of The Wall Street Journal)

The Farm Credit System will need "multibillions of dollars" in federal aid in 18 to 24 months, the system's chief regulator warned, but some bankers in the system and farm economists think help must come sooner.

Donald Wilkinson, governor of the Farm Credit Administration, which oversees the huge farm-bank cooperative network, told a news conference at the agency's new headquarters in McLean, Va., that the system is "approaching the time when it will require federal financial assistance unless major new forces alter" existing trends in the agricultural economy. The trends include declining crop prices, farmers' increasing inability to repay loans and falling land prices, he said.

Mr. Wilkinson declined to specify how large a government rescue plan would be needed, saying the amount depends on the type of bailout. He mentioned, as options a new corporation to take over bad farm loans, direct federal cash, guarantees for farm loans or a federally financed reduction in farm-loan interest rates.

Soundings on Capitol Hill

But some soundings on Capitol indicated a bailout plan could be immense. Senate Majority Leader Robert Dole (R., Kan.), after meeting with Marvin Duncan, a credit agency deputy governor, said, "There's no doubt in my mind that the Farm Credit System is in need of a major overhaul and possible restructuring."

Nonperforming loans by all farm lenders, including those outside the Farm Credit System, could reach $50 billion in the next year or two, Mr. Dole said. Nonperforming loans are ones that aren't being repaid.

Top credit agency officials emphasized that the system faces no immediate threat of insolvency. But Mr. Dole said that Mr. Duncan told him that enough of the credit system's 12 districts are "experiencing difficulties" that "some remedial action" is necessary in the next six to 12 months. Mr. Dole said he hopes Congress can provide a "legislative response" by the time it adjourns in December.

A Dole aide added that a "far-reaching and massive plan" would be required to cover all bad farm loans, "something like (the equivalent of) three or four Continental Illinois Banks." Last year's federal rescue of Continental Illinois Corp.'s bank involved a $4.5 billion bailout. He added that the government cannot avoid tackling the problem.

Reagan administration officials have insisted this week that they don't plan any direct assistance for the credit system. But they acknowledge they're studying possible future options for such help. And Mr. Wilkinson said yesterday that long negotiations with the administration and Congress, and "much understanding" on their part, are needed for any bailout plan to be devised.

A spokesman for the credit agency added that the administration is "willing to help," but it insists that the system first apply its own resources to its financial difficulties.

The Federal Farm Credit Board, the credit agency's policy-making body, took a step in this direction Wednesday by empowering Mr. Wilkinson to transfer assets among the system's approximately 800 units in an effort to better absorb loan losses.

The board also endorsed Mr. Wilkinson's decision to seek federal help. The board said it concurs that farm lenders, including the system's banks that hold $74 billion in farm loans, "are rapidly approaching the point" of requiring government assistance "to continue to meet the credit needs of agriculture."

Pressure for Assistance

In fact, government help could be needed much sooner than the 18 to 24 months indicated by Mr. Wilkinson.

Some farm economists, and even system bankers, suggest that the farm economy's dizzying decline could force the system to lean on federal support within a few months.

"Without a miracle, they may only have until next spring," said Neil Harl, an Iowa State University agricultural economist who has been a consultant to several banks in the system. And a system banker adds, "I think we have to move within six months at the outside. I'd like to see it by year-end."

If Congress spurns administration pleas to slash farm-price supports for budgetary and other reasons--as it's likely to do while it keeps tussling with a major new farm bill--that could provide some breathing room.

Farm and financial-market experts said that although it may take a while to exhaust the system's $10 billion in capital and loan-loss reserves, the system is so vulnerable to a crippling liquidity crisis that it cannot wait long before needing federal aid.

Apparently reflecting some new Wall Street concerns about the credit system's viability, interest rates on system bonds rose in the past two days while bond prices in general declined, though the changes abated yesterday.

Meanwhile, the credit agency's previously reported action empowering Mr. Wilkinson to speed up transfers of funds within the system could worsen a steady exodus of financially strong farm borrowers from the system. Transfers will force stronger banks, who lose funds, to boost their lending rates, some observers said.

Mr. Wilkinson also said further regulatory powers are needed, such as agency authority to levy monetary penalties on system units for illegal banking practices, issue cease-and-desist orders and remove local officers and directors, when necessary. Other federal banking regulators have similar powers, and legislation recently introduced in Congress would give such powers to the Farm Credit Administration.

Farm experts said the most immediate need is to bolster the system's weakest banks. At the end of the first quarter, eight of the system's 37 main banks had more problems loans than capital--a harbinger of failure. The system's 12 intermediate credit banks as a group had more problem loans than capital.

The system's most troubled banks, according to recent data, are the intermediate credit banks in Spokane, Wash., and Omaha, Neb., with problem loan-to-capital ratios of 605% and 271%, respectively. The Spokane bank received a $125 million bailout from the system's other banks in February; the Omaha bank is in the process of implementing a $435 million bailout approved last month.

Also among the system's most troubled banks are the land bank in Columbia, S.C., with a problem loan-to-capital ratio of 173.3%; the intermediate credit bank in Sacramento, with a ratio of 143.1%; and the land bank and intermediate credit bank of Wichita, Kan., with ratios of 107% and 105%, respectively. None of those banks has yet requested a bailout from the system.

[Reprint from The Wall Street Journal Friday, September 6, 1985]

COMMERCIAL AGRICULTURE BANKS' WOES FROM FAILING FARM ECONOMY INTENSIFY

(By Charles F. McCoy, Staff Reporter of The Wall Street Journal)

The crumbling agricultural economy is taking in increasingly heavy toll on the nation's teetering commercial farm banks.

Recently released data from the Federal Deposit Insurance Corp. show that the number of farm banks with more problem-loan exposure than capital--a leading indicator of failure--surged to 135 at the end of the first quarter. That's up sharply from 89 at year-end and from 60 in June 1984.

The FDIC's list of problem banks now includes 402 farm banks, up from 371 in June and 340 at year-end. And of the 76 banks that have failed so far this year, 42 have been agriculture banks.

Things Are Getting Worse

"Things are getting worse fast enough to spin your head," says Earl Hall, president and chief executive officer of Fairview State Bank, Fairview, Okla., which had a ratio of problem loans to capital of 189.3% at the end of the first quarter. "It's not very pretty".

The situation is expected to get much worse in coming weeks. Fundamental farm economics continue to deteriorate at dizzying rates: Land values, the collateral underpinning most farm debt, slid another 5% to 6% in many parts of the Farm Belt; in some areas, the declines in land value have eroded as much as half of the collateral backing up loans made at a time of inflated land prices during the 1970's and 1980's.

Commodity prices, driven down by the prospect of a gigantic fall harvest, are hovering near seven-year lows and aren't expected to rebound significantly. Beyond that, the troubles of the Farm Credit System, which is seeking federal assistance to cope with a massive amount of bad loans, is expected to heighten a credit crunch this fall. That could force more farmers out of business and throw more land onto an already glutted market, driving land prices down further and souring more farm-bank loans.

Bank's Farm Debt

Farm banks--so called because at least 25% of their loans are in agriculture--and other commercial banks hold about $51 billion of the nation's $120 billion farm debt. Some farm economists now believe as much as half of commercial banks' farm debt--$25.5 billion--is uncollectable.

The worsening conditions continue to drive small banks under at an unprecedented rate and to hammer at some of the larger ones, as well. Much of Bank of America's $338 million second-quarter loss came from hemorrhaging in its $1.7 billion agriculture portfolio.

Hawkeye Bancorp. of Des Moines, Iowa, the state's largest bank holding company, with assets of about $1.9 billion, had a six-month net loss of $6.5 million. Its president and chief executive, Paul Dunlap, says the bank is likely to have a loss for the year. "We're hurting and we don't see much out there to make us feel any better," Mr. Dunlap says.

Many farm experts think many banks have been set up for a beating by bankers' decisions to continue financing many essentially broke farmers this spring in hopes that a farm turnaround would bail them out this fall. Only 5% of all farmers were denied planting loans this year, despite many farm economists' beliefs that 10% to 15% weren't credit-worthy. But now, with farm income expected to drop to about $20 billion from last year's $33 billion, "even some guys who were more or less all right are going to be shoved onto the critical list," says George Norden, president of First National Bank of Paulina, Iowa. "If you stuck with guys who were questionable, you can just about forget 'em."

Adds W.H. Shirley, a farm bank consultant based in Merriam, Kan.: "This fall we're going to see bad farm loans rising through the roof and the number of essentially insolvent institutions is going to rise right with it."

[Reprint from The Washington Post, Friday, September 6, 1985]

FARMERS' LOSSES PUSHED OFFICIALS INTO GOING PUBLIC

Investor Confidence, Cost of Funds Were at Stake

(By John M. Berry, Washington Post Staff Writer)

Officials of the Farm Credit System, faced with a deteriorating farm economy and the likelihood that loan losses will mount sharply, decided that they had to go public with the system's plight, although in the short run, it would undermine investor confidence in their securities and increase the cost of raising funds in the market.

Analysts said the system was forced to take the risky step because obtaining federal help is likely to be a difficulty and lengthy political process that must be begun now.

The Farm Credit System like other financial institutions, lives on investor confidence, a confidence that is being shaken by publicity about large potential loan losses.

The $74 billion system, a decentralized network of locally controlled lending organizations funded through a dozen Federal Intermediate Credit Banks, provides more than one-third of the money borrowed by farmers.

The system raises all its loan money by selling securities; no federal funds are involved.

Should investor confidence be shaken enough, the system could find itself unable to raise money to pay off maturing securities, some financial analysts warned yesterday.

Such a development, still regarded by analysts as a remote possibility, could produce financial chaos in the farm sector and huge losses for investors holding the system's securities and for farmers who, as a condition of getting credit, bought stock on the system.

So far, the system has absorbed its losses and maintained a substantial new worth, estimated at more than $10 billion at the end of March by the Farm Credit Administration, a federal agency that oversees the system. Meanwhile, dividends are still being paid on the stock.

However, the system may have $11 billion in uncollectable loans, possibly more, according to estimates by sources in the system.

Only about $1 billion has been set aside to cover possible losses, the FCA's March report said.

Most of the securities issued by the system are held by both domestic and foreign institutional investors such as commercial banks, insurance companies, savings and loan associations and corporations. Some are also held by individuals.

The securities have no federal guarantees, but investors have treated them as if there were guarantees.

Normally, the system has raised money by paying only about 10 or 15 basis points above the yield on regular U.S. Treasury securities of similar maturities. A basis point is one-hundredth of a percentage point.

Because of looming problems, the spread had risen to 25 to 50 basis points. Publication of a Wall Street Journal story Wednesday saying system officials were going to seek some form of direct federal assistance raised that spread further to 50 to 75 basis points and reduced the number of transactions in the securities, said one trader at a New York bond dealer.

The dealer said that investors regard the system's securities has having a "moral obligation" type of government guarantee even if there is no legal guarantee. Foreign investors, he added, are even more confident than American investors that the U.S. government would not let the system collapse.

At the moment, no one knows how much of a rescue package might be needed, except that FCA Governor Donald E. Wilkinson said it will have to be "multibillions of dollars."

But while the Farm Credit System is facing losses, so are many agricultural banks--those with more than one-fourth of their loans in agriculture--and a number have failed in the last two years. The Federal Deposit Insurance Corp. has more than 400 such banks, mostly small, on its list of problem banks. Assisting the Farm Credit System without helping the banks, too, could be politically difficult.

Public disclosure of the system's plight will have an impact on the entire farm credit issue, and officials avoided it as long as possible.

Last month, the system chose to use cash on hand to pay off some maturing notes rather than make the disclosures that would have to accompany a new securities issue. By late this month or early next month, the system normally would be bringing another new issue to market.

If the present holders of the system's securities were to decide to sell them, buyers would have to be found for those securities as well as any new ones. "It could be hard to find buyers, and there could be a liquidity problem," said one dealer. "It could be a real mess."

However, he added, "there are investors who think this thing will be solved" as was a problem a few years ago at another government-sponsored agency, the Federal National Mortgage Association, also known as Fannie Mae. The problem at Fannie Mae was not loan losses but that the cost of the short-term money being borrowed by the agency was costing more than it was making on the long-term mortgages it had in its portfolio.

[Reprint from The Wall Street Journal]

TREASURY PRICES RALLY ON SPECULATION
FARM WOES MAY PREVENT TIGHTER CREDIT

(By Tom Herman and Edward P. Foldessy
Staff Reporters of The Wall Street Journal)

NEW YORK--Prices of U.S. government bonds rallied yesterday amid speculation that the woes of the nation's farm lending network will prevent the Federal Reserve System from tightening its credit hold.

Many investment managers have been worried that the explosive growth of the nation's money supply would prompt the Fed to tighten credit conditions, pushing up interest rates. Some analysis yesterday predicted that the Fed may even ease its credit grip in light of the economy's continued weakness and the farm belt's severe troubles.

The Federal Farm Credit System, the nation's largest single holder of farm debt, was reported yesterday to be seeking federal support for its $74 billion loan portfolio. Although Reagan administration officials ruled out any immediate plans to bail out the troubled system, one aide said they would look at the issue again if it became obvious that the Farm Credit System's finances were deteriorating severely.

Some long-term Treasury securities rose yesterday by about a half point, or $5 for each $1,000 face amount. But prices of Federal Farm Credit System issues slumped.

Flight to Quality

The Farm Credit System's financial woes also sparked what some dealers referred to as a "flight to quality" in the credit markets early yesterday. Traders reported a flurry of buying yesterday morning of short-term Treasury bills, which are considered the safest and most flexible investment.

The farm situation "is one more reason that the Fed will have to focus more on the economy and less on the money supply" in setting credit policy, said Maury N. Harris, chief economist at PaineWebber Inc. He contended that this "tilts the odds in favor of a drop in the discount rate," which is the fee charged by the Fed on loans to banks and savings institutions.

Mr. Harris predicted that the Fed will cut the discount rate to 7% from 71/2% before year-end. Such a move would bolster the economy and "keep the agricultural problem from spreading," he argued.

But some others expect little or no changes in Fed policy. They say the money supply's rapid growth soon will lead to faster economic expansion and increased pressure on consumer prices. Some analysts question the significance of the money supply figures, but they say the Fed can't afford to ignore the data even though the economy remains in the doldrums.

Outlook for GNP

Elliott Platt, senior vice president and economist at Donaldson, Lufkin & Jenrette Inc. says the economy is continuing to grow at a "relatively slow" pace. He estimates that the gross national product, adjusted for inflation, will expand at a 2% to 3% annual rate this quarter. That would compare with a disappointing 1% pace in the first half.

The Farm Credit System's problems "make it even less likely that the Fed will tighten credit conditions," said Mr. Platt. But the money supply's rapid growth "precludes the Fed from easing" credit conditions, leading to a "stalemate" in Fed policy.

Analysts are bracing for another large increase in the basic money supply, known as M1, to be reported this afternoon by the Fed. The median estimate of 36 analysts surveyed by Money Market Services Inc. of Belmont, Calif., shows a $2.5 billion increase for the week ended Aug. 26.

Far Above Target

That would leave M1, which consists of checking deposits plus cash held by the public, far above the Fed's target. The Fed's target calls for a 3% to 8% annual growth rate in M1 for the second half of this year.

The following table shows the lower and upper limits for M1 implied by the Fed's target, when it is depicted in the traditional way to resemble a cone. The middle column shows figures already reported, in billions of dollars:

Week Ended	Lower	Actual	Upper
July 22	$586.0	$595.5	$591.6
July 29	586.3	596.8	592.5
Aug. 5	586.6	602.1	593.4
Aug. 12	587.0	603.2	594.3
Aug. 19	587.3	606.0	595.1
Aug. 26	587.6	.....	596.0
Sept. 2	588.0	.....	596.9
Sept. 9	588.3	.....	597.8

Here are the limits implied by the target based on a more flexible method using two parallel lines:

Week Ended	Lower	Actual	Upper
July 22	$581.5	$595.5	$596.1
July 29	582.1	596.8	596.7
Aug. 5	582.7	602.1	597.3
Aug. 12	583.3	603.2	597.9
Aug. 19	583.9	606.0	598.5
Aug. 26	584.5	.....	599.1
Sept. 2	585.2	.....	599.8
Sept. 9	585.8	.....	600.4

In the credit markets yesterday, the Treasury's 10 5/8% bonds due 2015 closed at a price of 102 2/32, up from 101 21/32 Tuesday. That lowered the yield to 10.40% from 10.44%. The government's 10 1/2% notes due in August 1995 rose to 102 6/32 from 101 25/32, reducing the yield to 10.14% from 10.20%.

By contrast, prices of some Federal Farm Credit bonds tumbled by about a point, or around $10 for each $1,000 face amount. For example, the 11.45% bonds due in 1994 fell to 103 10/32 from 104 12/32 late Tuesday on some dealers' quotation sheets. "We did some selling, but there was no big deluge," one trader said.

Among Treasury bills, the latest 13-week issue closed at 7.04% bid, down from an average rate of 7.12% set at auction Tuesday. At one point early yesterday, the issue traded at about 6.95%. The bid on the latest 26-week Treasury bill declined to 7.21% from the auction average of 7.30%.

In the municipal bond market, several large new state and local government bond issues were tentatively priced yesterday by underwriters for offering to investors. These included:

--About $256.6 million of revenue bonds by the Indiana Toll Finance Authority. Smith Barney, Harris Upham & Co. heads the underwriting group. The bonds were tentatively prices to yield from 6.75% in 1988 to 9.55% in 2014.

--About $238 million of home purchase revenue bonds by California's Department of Veterans Affairs.

[Reprint from The Wall Street Journal, October 3, 1985]

BLIGHTED LEDGERS--FARM CREDIT SYSTEM RELIES ON ACCOUNTING THAT HIDES BAD LOANS

But the Truth Might Rattle Investors Who Fund It; They Cite Hassle Factor

(By Charles F. McCoy and Jeff Bailey
Staff Reporters of The Wall Street Journal)

There's something odd about some of the loans on which a Federal Farm Credit System banker in Illinois has been recording interest payments--and thus profits--over the past two years: The borrowers haven't paid a penny of interest in all that time.

"Aw, that's not so strange," says Ronald Gilsrud, a system banker in St. Paul. "We're accruing payments on some [loans] here that are three and four years delinquent."

Both bankers say such bookkeeping is legitimate under the system's accounting rules. But it's now evident that the rules themselves aren't so legitimate.

For years, the Federal Farm Credit System has played by a set of home-brewed accounting standards that have masked bad lending and lax regulation. Loosely interpreted and poorly understood by some of the system's own officials, the rules have kept alive loans that accountants and commercial-bank regulators say other lenders would have been forced to give up as hopeless. They appear to have left the system with hundreds of millions of dollars of still-unrecognized losses and only a hazy notion of where its finances really stand.

Crucial Issue

In calmer times, the system's tangled bookkeeping would be little more than grist for esoteric debates among accountants, and the mess could be straightened out with gradual tinkering. But the farm economy's collapse has suddenly turned subtle accounting anomalies into the difference between modest losses and catastrophic ones. Even though the Farm Credit System has asked for a federal bailout of its $74 billion loan portfolio, many accountants and bankers doubt that the system has yet to fully own up to its problems.

The accounting conflict has forced the system's managers into a dicey game of balancing congressional demands for a full reckoning of its ills against an increasingly skittish community of investors who finance it and have already been rocked by too many surprises.

"They've got an accounting nightmare on their hands," says S. Thomas Cleveland, the national banking director of the Big Eight accounting firm of Touche Ross & Co. and a former consultant to some of the system's banks. "It helped get them into this mess, and it's going to make it tough to hold things together while everybody tries to figure out how to fix it."

On Friday, the government's General Accounting Office projected that the Farm Credit System will have a net loss of $2.6 billion--the biggest annual deficit in banking history--for the

12 months ending June 30, 1986. The GAO also questioned the accuracy of some of the system's financial data.

A Sort of Confederation

Holder of more than one-third of the nation's staggering $212 billion of farm debt, the system is a crazy-quilt confederation of 12 regional banks, each with a land bank for land loans, an intermediate credit bank for planting loans and a bank for farm cooperatives. The system finances its loans by selling bonds and notes; it has about $70 billion worth outstanding. They aren't government-backed, though the system's regulator, the Farm Credit Administration, is a federal agency.

Price Waterhouse promptly turned up $6 billion of current but poorly collateralized land-bank loans that the system's bankers and examiners hadn't adversely classified. Some of the loans will result in "significant losses," the accounting firm says.

More adjustments seem likely. "If the system does a serious audit, using the same rules commercial banks use, it'll blow the roof right off 'em," says Paul Dunlap, the chief executive officer of Hawkeye Bancorp., Iowa's leading commercial farm lender.

The loss of credibility has already been costly. It has turned what had been bluechip obligations into the "junk bonds" of so-called government agency issues. That's dangerous because the traditional buyers of the system's securities have been risk-averse investors--bank trust departments, insurers, pension funds and municipal treasurers.

Already, the system has seen the universe of investors in its bonds and notes shrink. It has to pay a stiff premium for funds. And, hat in hand before Congress, it must listen while farm-state legislators advance proposals that horrify bond buyers. Fore example, Rep. James Leach, an Iowa Republican, introduced a bill that includes a possible 20% discounting of the bonds. "Iowa farmers have had half their assets wiped out," he explains. "The bond market should share in that."

Such talk has helped taint the system's bonds with "the hassle factor"--when money managers refuse to hold troubled obligations because of the aggravation of defending the decision to their bosses, or clients, no matter how rich the yields. "I fear default, but who needs the headaches?" says James Russell, vice president of corporate investment at Metropolitan Life Insurance Co. Mr. Russell dumped his $5 million position and won't be back anytime soon, he says. "The hassle factor is just too high now."

Likewise, Kemper Financial Services Inc., a Chicago-based money-fund manager, won't roll over $100 million in Farm Credit bonds maturing in November. "They're dollar-good, but there's going to be more bad news," says Frank Rachwalski, a vice president. "We don't feel comfortable."

Other big institutional investors that have recently shunned the system's obligations include Hutton Government Fund Inc,. an E.F. Hutton Group Inc. money fund; Cigna Corp.'s Cigna Investment Management Inc. money-fund unit; Wells Fargo & Co.'s trust department, and First Interstate Bancorp of Los Angeles.

Of course, some investors, lured by fat yields and convinced that the government won't permit a default, are loading up. New Jersey's Division of Investment has increased its stake in system securities to more than $800 million from $595 million. "At these spreads, it's a tremendous buying opportunity," says Roland Machold, the division's director.

But that's little consolation to Peter J. Carney, the president of the Federal Farm Credit Banks Funding Corp., which sells the securities. Historically, the system has had to pay as little as two to five basis points (a basis point is one-hundredth of a percentage point) more than the U.S. Treasury does for funds. The spread has widened to between 80 and 100 basis points and, as the system rolls over each issue of notes and bonds at higher rates, that penalty deepens its operating losses.

Now that the system is in trouble, its financing needs seem staggering. To get new cash and roll over old debt, it sells about $250 million in short-term notes every day and raises some $100 billion a year.

The Federal Reserve Board has said it will help out if the system can't meet its financing needs. At present, however, the system still seems to have kept liquid, with the aid of the 150 banks and brokerage firms that deal in its securities and the many investors trusting in a bailout.

Mr. Carney is confident that he won't need the Fed. In an interview, he defended the system's accounting practices and predicted that Price Waterhouse will render a "clean" opinion, free of qualifications. (William Linnenbringer, the Price Waterhouse partner in charge of the audit, declined comment. However, he sat in on the interview with the system's funding officials and advised them extensively on their answers. But he spoke on the condition that he not be quoted.)

But interviews with commercial bankers, regulators, accountants and some system officials show that the system's financial statements won't regain credibility easily.

The system reported earnings of $441.6 million last year and $96.2 million for the 1985 first half. But accountants suggest that those profits were illusory, built on inadequate reserves for loan losses, a questionable policy of booking interest not yet received on troubled loans and overvalued collateral, especially farm land. Adhering to commercial-bank guidelines, they say, could mean operating losses that would dwarf the projected 1985 deficit of $350 million to $400 million.

In the past 2 1/2 years, the system has charged off about $1 billion in loans, or 1.3% of the total. By comparison, Norwest Corp., a Minneapolis-based bank holding company, estimates that it wrote off 10% to 12% of its $1 billion in farm loans during that period. Bank America Corp. estimates that it will charge off 5% of its $2 billion farm-loan portfolio this year alone. In 1984, all banks charged off 2.2% of farm loans; the system charged off less than 0.5%.

The system's reserve for future loan losses is expected to reach $1 billion by year-end--also 1.3% of loans. But compared with its huge load of problem credits, "that is awfully low," says Thomas H. Asson, the chairman of the banking group at

Coopers & Lybrand, a Big Eight firm. Norwest's reserve is more than 10% of its agricultural exposure.

Mr. Carney counters that the Farm Credit System's loans are largely secured by first mortgages on land, whole most commercial banks make production loans either unsecured or junior to first mortgages.

However, the plunge in farm-land prices raises the question whether the system's loans are really better. And the likelihood of further commodity-price declines leaves even current land prices inflated, many bankers say. But it is the value of land on which the system relies to avoid bigger loan losses and an increase in non-accruing loans.

Until last year, the system kept booking interest until it began foreclosure proceeding. "If the first time you recognize the loan's a problem is when you foreclose, you've really got a problem," says Forrest L. Ward, a partner at Arthur Young & Co., a Big Eight firm.

Commercial banks must stop accruing interest on loans 90 days or more past due, unless the loan is both well secured and in the process of collection. "It's common sense," says Zane D. Blackburn the director of bank accounting for the comptroller of the currency. "If a guy hasn't paid you what he owes you in three months, you shouldn't be recognizing payments until you receive them."

What's more, some accountants say it's almost impossible these days to call well secured a loan collateralized only by farm land.

Nevertheless, the Farm Credit System, as of June 30, continued to book interest on more than $9 billion of problem loans and had just $2 billion on nonaccrual (excluding the $6 billion in poorly collateralized loans that Price Waterhouse recently turned up). Mr. Carney, the funding cheif, and Larry W. Edwards, deputy governor and chief examiner of the Farm Credit Administration, both say they don't know how much of the more than $9 billion is 90 days or more past due. They refused to provide the figure but insisted that it is kept at the regional banks.

That's true in some cases. At the land banks in St. Louis and Columbia, S.C., for instance, about half the problem loans still accruing interest are 90 days or more past due. But at the Omaha bank, Walter Patterson, a spokesman, says, "I've checked with everybody, and we don't have that figure here. I don't know who has it."

Such confusion is widespread and perhaps the most troubling factor to people trying to assess the system's true condition. In a recent interview, Burgee Amdahl, the head of the district bank in St. Paul, stared blankly as a reporter showed him financial data prepared on his bank by the Farm Credit Administration.

"I've never seen these numbers, and I don't know where they got them," he said. "It may be amazing to you that a $74 billion shop like our system can't say where it stands."

[Reprint from The Wall Street Journal, Monday, October 7, 1985]

FARMERS COMPLAIN THAT CREDIT SYSTEM'S CRISIS, OTHER MOVES ARE TIGHTENING SQUEEZE ON THEM

(By Marj Charlier and Wendy L. Wall
Staff Reporters of The Wall Street Journal)

KANAWHA, Iowa--Marvin Holck says he could make a $41,000 land payment that he missed in March if he could just harvest his bumper corn crop.

But the Federal Land Bank branch in nearby Mason City doesn't want to wait to get its money; it started foreclosing on Mr. Holck's farm last month. "I think I could work my way through this thing," says a frustrated Mr. Holck, framed by the dining-room window that overlooks a vast feild of 10-foot corn. "What disturbs me is there is no forbearance at all."

Despite abundant harvests, thousands of farmers such as Mr. Holck will soon lose their farms. The crisis in the Farm Credit System, which is seeking a federal bailout, is tightening the credit squeeze on farmers and raising their interest costs. The Farmers Home Administration, long the farmers' lender of last resort, is trying to curtail its direct lending. And as more and more rural banks fail, federal regulators are forcing widespread loan writeoffs--in effect, pulling the plug on many borrowers.

Skakeout Expected

With credit tightening on all fronts, "the shakeout (in the farm sector) is bigger than what we've been talking about up to now," says Raymond Daniel, the chief agricultural economist with Chase Econometrics, a Bala-Cynwyd, Pa., consulting firm.

Overall, experts say, some 10% of the nation's farmers will be squeezed out this fall and next spring--about twice the number a year earlier. In some regions hit by drought and crop failures, as many as 40% may be turned down in the next round of operating loans.

The credit crunch also will raise the taxpayers' tab for government price supports. Cash-stained farmers are expected to participate in these programs in record numbers because government loans on their crops will exceed cash-market prices.

For despite a record corn crop, a bounteous soybean crop and more, the farm economy keeps eroding. In the short run, the bumper crops will enable most farmers to make fall payments on their land and operating loans. But grain and fiber prices have sunk under the weight of huge supplies, wiping out the cash-flow projections used by farmers to convince bankers that they can repay loans for seed, fuel and fertilizer. And farm-land values--the collateral that backs loans--continue to crumble; they dropped another 12% nationwide from April 1984 to April 1985. In Corn Belt states, the declines averaged 25%.

Past-Due Loans Mount

Meantime, past-due loans continue to mount. Iowa bankers, for instance, told the Chicago Federal Reserve Bank that 23% of their agricultural loans had repayment problems in the second quarter, up from 17% a year earlier.

The Farm Credit System--made up of production credit associations (which provide short-term financing to farmers), federal land banks and a bank for cooperatives--has become less concerned with saving farmers than saving itself. Facing third-quarter losses that may exceed $70 million, the system, which holds 30% of the nation's $212 billion of farm debt, is scrambling to tighten standards and get deteriorating loans off its books.

The tough foreclosure action by the Mason City land bank on Mr. Holck's loan was a marked departure from past, more lenient days. (Mr. Holck's bank declined to discuss his case.) And, when Loren Thompson, a Rolfe, Iowa, cattle, hog and grain farmer, missed a payment on his land loan in July, the bank called his loan and threatened to put a lien on 240 acres that he owns free and clear. Mr. Thompson's commercial banker said that if that happens, he won't lend him operating money next spring. "In this area, this hasn't happened since the '30s," Mr. Thompson says.

Farmers and state officials accuse land banks of scrapping their officially stated forbearance policies, strong-arming farmers in trouble and refusing to work out restructuring plans. In a public meeting last month, attorneys general from 11 Midwestern states reported a flood of complaints by farmers who had been denied access to their own records, a review of their loan cases and their rights as stockholders in production credit associations.

"We felt we hadn't been treated right," says Jon Larson, a Randolph, Kan., farmer who sued his land bank after having missed his first loan payment in 26 years and, soon thereafter, receiving a foreclosure notice. "They ignored normal procedures for delinquent loans, and they wouldn't even talk" about restructuring the loan. Only after he filed suit did the bankers agree to meet with him, according to Mr. Larson. Mr. Larson's banker says he couldn't restructure the loan because he was denied financial information.

Credit-system officials in Washington say they aren't dictating a hard-nosed approach to liquidations. Nevertheless, many presidents of production credit associations say they will turn down more farmers than ever next spring. "Our standards haven't changed, but the economy has," says Maurice Russell, the president of the PCA and land bank at Newton, Iowa. He expects that as many as 10% of his customers won't get new production loans next spring.

Tighter Credit

But former PCA loan officers say the PCAs have been tightening their credit policies. From July 1, 1984, to July 1, 1985, PCA lending dropped 13%, according to Federal Reserve figures.

Many PCAs now are requiring security behind planting and livestock loans, a rare practice five years ago.

Moreover, the interest-rate increases are driving away some of the federal system's best customers, as the most credit-worthy farmers seek better deals elsewhere. And when PCAs began freezing the stock that farmers must buy to get a loan, they also drove away good customers. "It weakens the overall strength of our portfolio," says Mr. Russell of the PCA, who adds that 40 of his customers have pulled out their stock and found new lenders.

This flight of healthy borrowers can ultimately ruin many of the PCA's remaining farmers. It led to the liquidation, earlier this year, of the Glendive, Mont., PCA. One-third of the 300 farmers with loans there haven't found a new lender, according to Perry King, agricultural loan officer at First Fidelity Bank in Glendive. About 50 never will get loans, he predicts.

First Fidelity did pick up 95 of the stranded PCA customers, but commercial banks are hardly a haven for distressed farmers these days. Federal bank examiners are increasingly demanding loan writeoffs that force farmers out of business--ending an era of loose asset accounting that, some bankers say, delayed the current reckoning.

Strict Examiners

Many bankers say examiners are classifying farm loans with excessive zeal. At congressional hearings last March, Paul D. Dunlap, the president of Hawkeye Bancorp., a bank holding company based in Des Moines, alleged that 50 Hawkeye loans had been pushed into lower classifications than necessary by examiners, forcing at least 10 farm liquidations. More recently, he said in an interview, some examiners wouldn't even credit farmers with income from the coming harvest. Bankers say regulators are thus causing unnecessary casualties.

"Considering the times, the examiners aren't generally wrong (about loans being problems), but they don't give you the workout time that could save a customer," says Frank L. Farrar of Britton, S.D., who owns 10 farm banks.

For the most vulnerable banks and their farm clients, things may get worse. In late June, the comptroller of the currency ordered a special report from them; requiring detailed information on the makeup, crop by crop, of their ag-loan portfolios. By tracking crop and livestock prices, the comptroller hopes to anticipate which farm banks are most vulnerable and to enable examiners to zero in on trouble institutions, says John F. Downey, the comptroller's chief national bank examiner.

And just as the credit squeeze tightens the Farmers Home Administration has decided to shed its role as the farmers' lender of last resort. In the past year, the agency lent desperate farmers $3.4 billion and guaranteed another $1.1 billion in commercial-bank loans.

But the administration is backing away from such off-budget spending, and the agency is nervous about its exposure. "We took an awfully heavy load last year," says Agriculture Department Under Secretary Frank Naylor. In the fiscal year that began Oct. 1, Farmers Home wants to limit its direct spending to

$2 billion and raise its guarantees to $2 billion. Within three years, it hopes to quit direct lending altogether.

Some farmers also may call it quits. Last spring, Richard Sowers of Story City, Iowa, was turned down for a direct loan by Farmers Home, but the agency was set to guarantee a loan from his local bank--when the bank failed. With credit from local suppliers, he had purchased seed and fertilizer and planted a crop, he says, "on a whim and a prayer." But many suppliers--whose own resources are also strained--aren't likely to extend credit to farmers such as Mr. Sowers again.

"I hope I can find a job," a dispirited Mr. Sowers says. "To hell with farming."

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FARM CREDIT SYSTEM LOSS OF $2.6 BILLION SEEN BY GAO FOR YEAR ENDING JUNE 30

(By Charles F. McCoy and Jeff Bailey
Staff Reporters of The Wall Street Journal)

The General Accounting Office projected that the Farm Credit System will have a loss of $2.6 billion for the 12 months ending next June 30, and questioned the validity of some of the system's financial reports.

Such a loss would be the biggest in banking history, more then double Continental Illinois Corp.'s $1.1 billion deficit in 1984.

James Roll, a senior vice president of the Farm Credit System funding arm, attacked the method used by the GAO to arrive at the projection, saying the method "is open to serious question." He added that the system is updating its financial data and expects to have, before Oct. 31, its own projection of performance.

Responding to GAO questions about the accuracy of the system's financial reports, Mr. Roll said: "I haven't any comment except that we are working diligently to get the best data we can."

Craig A. Simmons, associate director of the GAO's General Government Division, said system officials had cautioned the GAO that "misinterpretations" of the projections could weaken the system's already shaky funding capability.

The system, the nation's biggest farm lender with $74 billion loans, is a loose network of 12 district banks with hundreds of local lending outlets. It is seeking federal aid to rescue it from an avalanche of bad loans triggered by agriculture's collapse.

The GAO review began three months ago at the request of several congressmen. The projections, extrapolations based on the system's June 30 financial data, assume a persisting farm slump, little change in the system's current method of establishing reserves for future losses and elevated funding costs. The system sells bonds to finance its loan; news of the system's woes have driven the spreads on those bonds to 80 to

100 basis points above comparable Treasury bills. A basis point is 1/100 percentage point.

The analysis suggests that even the huge projected loss may be understated. The GAO predicted that the system's nonaccrual loans--those troubled credits on which it records interest payments only as they're received--will triple to $6.1 billion by mid-1986. The estimated loss is based on the system's ratio of loan-loss reserves to non-accrual loans remaining at its current 0.5%; that ratio is considerably lower than the average 1.3% ratio maintained by all commercial banks.

The GAO said that, if the system were to raise its loan-loss reserves to the levels maintained by commercial banks, the net loss would reach a staggering $7.4 billion by mid-June. That would wipe out the current $6.7 billion of earned net worth, the system's main source of primary capital.

The system has made one projection to date foreseeing a net loss of between $350 million and $400 million for the year ending Dec. 31. Peter J. Carney, head of the system's funding operations, said in a recent interview the system's reserves, expected to exceed $1 billion by year's end, are "adequate based on what we know now." He couldn't be reached for comment yesterday.

The GAO noted that the system's loan-loss reserve as a percentage of total loans has been declining since 1979, despite a marked upsurge in loan charge-offs. "That is simply not a prudent credit policy," said the GAO's Mr. Simmons.

The GAO estimated that the system's loan losses will reach $1.1 billion in the 12 months ending June 30. For the first six months of 1985, the system charged off $246 million in bad loans. The GAO said its review showed "dramatic deterioration" in the system's loan portfolio in the first six months of 1985; because of the time lag in recognizing losses, that indicates that "loan losses will significantly increase during the next 12 months."

Mr. Simmons and other GAO officials also voiced concerns that the financial data on which their review is based isn't accurate. Since the system's books closed June 30, a special credit review by Price Waterhouse, the Big Eight accounting firm, has turned up $6 billion in current but poorly collateralized farmland loans missed by the system's bankers and examiners.

GAO officials also cited an internal review of the intermediate credit bank in Omaha, Neb., which required a system engineered $435 million bailout that got underway last month. Bob Hart, a GAO auditor, said the Omaha internal review uncovered $157 million in loans that should have been written off but weren't; in addition, he said, the review found another $250 million in loans that should have been classified as "high risk" but weren't.

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FARM CREDIT SYSTEM REPORTS 3rd-PERIOD LOSS

Deficit Totals $522.5 Million, and More Loan Troubles Predicted Through 1987

(By Charles F. McCoy, Staff Reporter of The Wall Street Journal)

The Farm Credit System reported a third quarter loss of $522.5 million and projected that it may have to absorb $3 billion or more of loan charge-offs through 1987.

The system also said it may have to cope with as much as $10 billion of "non-earning assets"--bad loans and land acquired through foreclosures on which the system earns nothing--over the next two to three years. Such a bulge in bad assets would drastically erode the system's capital and drain earnings for years.

The loss and the grim projections, termed "shocking" by one money manager, come as the system is preparing to ask Congress for a federal bailout for its $70.7 billion in farm loans.

"We've seen the numbers, and we find nothing surprising about them," said Frank Naylor, an undersecretary of agriculture. "We're concerned about their problems and are studying alternatives, but we remain convinced their substantial resources can deal with them. We're pleased that they're getting a clearer picture of where they stand."

Many observers, however, still doubt whether the system has an accurate fix on its potential losses. The system had a loss of $426.3 million for the nine months. As recently as two weeks ago, system executives were officially sticking to projections made last month that the loss for all of 1985 wouldn't exceed $400 million.

However, the system said yesterday that "additional losses" are expected in the fourth quarter. It wouldn't specify, but it said Price Waterhouse, the Big Eight accounting firm hired to give the system its first outside audit in 50 years, will work with the system on a bank-by-bank scrutiny of the loan portfolio in the fourth quarter; no such review was conducted in the third quarter, system officials said. The third-quarter figures are unaudited.

In the 1984 third quarter, the system reported earnings of $126.4 million. For the year-ago nine months, the system earned $363.1 million. In all 1984, the system earned $441.6 million.

The system is the nation's biggest farm lender. It consists of 12 district banks, each with a land bank for farmland loans; an intermediate credit bank that makes short-term loans through local production credit associations; and a bank for farm cooperatives. There is also a central bank for cooperatives.

The system's results don't reflect the heavy losses at its hundreds of credit associations, which are reported separately. The \system said loan charge-offs at the credit associations would approach $500 million in 1985, almost double last year's charge-offs of $285 million.

The system also said more of its intermediate credit banks may need system-engineered bailouts because of the ballooning credit association losses. To date, the intermediate credit banks in Omaha, Neb., and Spokane, Wash., have required financial rescues of $435 million and $135 million, respectively. Those funds have been siphoned from the system's less-troubled banks.

The system said its allowance for future loan losses increased to $1.1 billion as of Sept. 30, from $745.1 million at June 30. Non-accrual loans--loans on which no interest or principal payments are being recorded--swelled to $3.5 billion, or nearly 5% of all loans, compared with $2 billion at June 30. Almost the entire increase came from the adverse classification of past-due loans on which the system had formerly been recording interest that wasn't actually being paid.

The system still has $1.6 billion of past-due loans on which it is accruing interest payments it isn't receiving. The General Accounting Office, which recently estimated the system would lose $2.6 billion in the 12 months ending June 30, and several Big Eight accountants have questioned the system's generous policy of booking unpaid interest and other accounting practices. But James Roll, a senior vice president of the system's funding arm, said the remaining past due but accruing loans are "well-secured" and "no losses on them are anticipated."

The earnings announcement came shortly before the market closed and sparked little activity in the bonds the system sells to raise funds. The system has $68.3 billion in bonds outstanding.

Some traders said the losses and projections were no greater than expected. But traders and institutional investors said the gloomy outlook will intensify the pressure on the system's shaky funding. The system's bonds, which early this year traded at spreads of only two to five basis points above comparable Treasury bill rates, closed yesterday at roughly 95 to 125 basis points above comparable T-bill rates. A basis point is one-hundredth of a percentage point.

Over the next year, the high spreads will boost the system's funding costs by hundreds of millions of dollars at a time when bad assets are expected to soar and earnings will be hammered.

"These numbers are just shocking, and the market is only now getting the full story," said Alex Laird, a vice president of Hutton Asset Management Fund. "The market will take its toll."

[Reprint from The Wall Street Journal, October 30, 1985]

FEDERAL OFFICIALS OFFER PROPOSAL ON FARM CREDIT

Reagan to Review Aid Plan To Provide Line of Credit For Agricultural Lender

(By Monica Langley and Albert R. Karr
Staff Reporters of The Wall Street Journal)

WASHINGTON--Senior White House officials are urging President Reagan to approve a plan to rescue the troubled agency that makes many of the nation's agricultural loans.

Treasury Secretary James Baker and Agriculture Secretary John Block have agreed on a plan to aid the Farm Credit System by establishing a line of credit for the system with the Treasury.

The compromise proposal was presented last night to the president, who didn't make a decision immediately, administration and Farm Credit System sources said. If approved by the president, the plan would be the first offer of federal assistance to the farmer-owned system since its rising tide of bad loans and extensive losses recently came to light.

"We decided that Farm Credit needed something from Treasury so there would be a belief in the market that it had underlying support from the federal government," an administration official said in an interview." A compromise was to give it something like a line of credit from Treasury."

Administration officials yesterday rejected any plan for a federal guarantee of the system's bonds. But the credit-line plan still represents a softening of the position of the Treasury, which initially opposed financial assistance of any kind. Along with the plan to establish a line of credit, the administration officials yesterday also agreed to propose regulatory reforms for the Farm Credit System when the administration testifies before a House subcommittee today or tomorrow, administration and congressional sources said.

Setting up a way for the Farm Credit System to tap into Treasury funds is expected to give the system's bonds a boost in the financial markets. In recent weeks, the bonds have been trading at widening spreads over Treasury bill rates, taking a toll on the Farm Credit System's funding operations. "Its rise in cost of funds is a big reason the proposal was approved," an administration official said.

The Farm Credit Administration has been arguing that the system can't survive its worsening credit problems without some form of federal aid. Although the federal agency regulates the Farm Credit System, the system itself isn't a federal agency and its debt securities aren't guaranteed by the government.

The plan would give the Treasury secretary discretion to disburse funds to the Farm Credit System under certain guidelines. "But the system can only draw on Treasury if it can't save itself," an official explained. A Farm Credit System official said that details, such as the size of the line of the credit and specific conditions, weren't provided to the system after yesterday's meeting of the cabinet-level Economic

Policy Council headed by Mr. Baker. Farm Credit System officials lobbied hard yesterday for the council to agree on the credit line.

The administration's proposal also includes methods aimed at helping the Farm Credit System reverse its decline. This would include a strengthening of regulatory powers for the Farm Credit Administration to make it a more independent regulator over the Farm Credit banks. It also would incorporate a clear authorization from Congress to allow the system's approximately 800 units to pool their capital, assets and reserves in an effort to absorb loan losses better.

Leaders of the Farm Credit System have been sounding out lawmakers on a tentative proposal for a congressional bailout of $10 billion or more that would involve using a corporation set up recently within the system. The corporation would take over problem loans and foreclosed farm property, using a loan from Treasury.

The administration resisted setting a specific amount to be automatically loaned to the system, fearing that a host of other troubles credited--ranging from sick thrifts to commercial banks that lend primarily to farmers--would ask for assistance, administration and congressional sources said. "We wouldn't agree to an immediate cash infusion or a guarantee for that reason," an official confirmed.

But the tentative agreement to establish some kind of credit line with Treasury is likely to help the Farm Credit System today when it sets the price on a $1.25 billion issue of six-month bonds for offering later this week. Before administration officials decided yesterday to present President Reagan with the line-of-credit proposal, traders had expected the system to pay about one percentage point more than the U.S. Treasury currently pays on similar obligations, thus substantially increasing the cost of funds.

The Farm Credit System has about $70 billion of notes and bonds outstanding, and if such an interest penalty were applied, its operating losses would deepen.

Even with the administration's proposal to provide the system with a credit line, the administration plans to tell Congress that the Farm Credit System has internal resources to help solve its problems, administration and congressional sources said. The suggestion for authorization to move around resources within the system, for example, is designed to help units in the worst shape.

[Reprint from the Congressional Record---Senate,
October 18, 1985]

FARM CREDIT SYSTEM HEARINGS

Mr. Helms. Mr. President, I read with great interest the remarks this past Wednesday of the distinguished Senator from Oklahoma [Mr. Boren] concerning the postponement of hearings on the difficulties confronting the Farm Credit System.

No one is more concerned about the current situation of the System or more eager to tackle this problem than this Senator.

I agree wholeheartedly with Senator Boren that this matter needs and deserves the attention of Congress at the earliest appropriate date. I have relayed to members of my committee, on more than one occasion, my strong intention to hold comprehensive hearings as soon as possible.

Mr. President, I agreed only with great reluctance to accommodate the requests of the administration, the Farm Credit Administration and the leadership of the Farm Credit System to postpone temporarily our hearings. Furthermore, as my committee knows, I attempted to schedule hearings in late September, but was asked by the System to wait until this week so they could be fully prepared to present testimony on their current financial situation and offer specific legislative proposals.

Mr. President, my decision to delay, for a short time, the commencement of our hearings was made only after being convinced that to have proceeded this week would not only have been unproductive, but could possibly lead to the deterioration of the System's ability to raise badly needed capital, at affordable cost, in the bond market. I hasten to emphasize that this is not because I expect to hear testimony that the collapse of the System is imminent, but rather because a premature hearing would produce negligible results and signal greater uncertainty to Farm Credit bond investors.

I might add that the chairman of the House Subcommittee on Agricultural Credit also recognized the necessity to postpone hearings and immediately accommodated the requests to do so. I trust no one would imply that the very able and respected Chairman Ed Jones would do so for any other reason than great concern and sensitivity to the complex issues involved. I understand that it has been Mr. Jones' intention from the beginning to separate the farm bill from the Farm Credit System issues and I commend him for it.

Indeed, I agree with Senator Boren that the problems facing the System are serious. But for that very reason we must proceed with thoughtful consideration to ensure that we not take precipitous action that would be detrimental to farmers who depend upon the System for a dependable line of credit. We must not ignore the obvious fact that even slight increases in the cost of Farm Credit bonds are soon reflected in higher interest costs to the very farm borrowers we are trying to assist.

Mr. President, I say without hesitation that while the problems facing the System are difficult, they are manageable. I fully anticipate that we will have viable options to consider in my committee in the very near future and I intend to expedite our reporting a bill to the full Senate.

With all respect, I must take exception with those who believe it is essential that we have a comprehensive solution to our agricultural credit problems before completing action on the farm bill. In fact, quite the opposite is true. Farmers must know what price they can expect from their crops before a thorough understanding of the credit situation can be achieved. To delay action on the farm bill will in no way further our efforts in reaching a sound, fiscally responsible solution to the farm credit problems.

Again, let me say that it is unfortunate that hearings on the Farm Credit System had to be again delayed. However, I assure all Senators that this is the Agriculture Committee. We will proceed with the consideration of it at the earliest appropriate date.

Mr. President, I ask unanimous consent that the text of letters from Under Secretary Frank Naylor, Gov. Gonald E. Wilkinson, and Mr. Delmar Banner requesting postponement of our hearings be printed in the RECORD.

There being no objection, the material was ordered to be printed in the RECORD, as follows:

DEPARTMENT OF AGRICULTURE,
Washington, D.C., October 15, 1985.

HON. JESSE HELMS.
Chairman, Committee on Agriculture, Nutrition,
and Forestry, U.S. Senate, Washington, D.C.

Dear Mr. Chairman:

I am writing to request your consideration in rescheduling this week's Agricultural Committee hearings concerning the operational status of the Farm Credit System.

On Friday, October 11, Secretary of Treasury James Baker, OMB Director James Mille, and I met with representatives of the operating leadership of the Farm Credit System and the Governor and Senior Deputy Governor of the Farm Credit Administration. The meeting was held to demonstrate the Administration's concern with the condition of the Farm Credit System's operating system.

On Friday, October 11, Secretary of Treasury James Baker, OMB Director James Mille, and I met with representatives of the operating leadership of the Farm Credit System and the Governor and Senior Deputy Governor of the Farm Credit Administration. The meeting was held to demonstrate the Administration's concern with the condition of the Farm Credit System's operating system.

During the course of the meeting, Secretary Baker indicated that the Administration was prepared to support a legislative package to deal with the organizational and regulatory reforms needed by the Farm Credit Administration and to improve the system's ability to pool its own resources to assist in managing its current problems.

The operating system reported to Secretary Baker that independent audit data would not become available until October 23 at which time operating results through the third quarter would be available for evaluation. This and other sources of financial information are vitally important in providing the administration, the Congress and the Farm Credit Administration with a more complete and accurate picture of the system's current and future operating conditions. It is the Administration's view that this data and an independent analysis of all available financial information are necessary to assess what additional measures, if any, may be appropriate.

Indicative of the Administration's concern, Secretary Baker has asked the Farm Credit Administration and the Farm Credit System to meet with an Administration working group to discuss further each of these issues and to develop the soundest possible assessment of current operating conditions.

Secretary Block and Secretary Baker are very much aware of your concern and commend you on your leadership in scheduling hearings to evaluate the Farm Credit System's status. The Administration believes that it is important to provide Congress with the soundest analysis that can be developed to assist you and the Congress in its oversight of the current operating problems of the Farm Credit System.

The Administration will appreciate your favorable consideration of this request and stands ready to work closely with you on this matter.

Sincerely,

FRANK W. NAYLOR, JR.,
Under Secretary for Small Community
and Rural Development.

FARM CREDIT ADMINISTRATION,
McLEAN, VA., October 16, 1985.

HON. JESSE HELMS,
Chairman, Committee on Agriculture, Nutrition, and Forestry,
United States Senate, Washington, D.C.

Dear Mr. Chairman:

We request that the hearing scheduled for October 17 be postponed.

Secretary James Baker met last Friday with Farm Credit System representatives and with the Farm Credit Administration as regulator of the System. He asked that the Administration be provided more complete information prior to any hearings so that it may develop more fully its position on the key issues likely to arise.

We appreciate your assistance in this matter.

Sincerely,

DONALD E. WILKINSON,
Governor

THE FARM CREDIT COUNCIL,
Washington, D.C. October 16, 1985.

HON. JESSE HELMS,
Chairman, U.S. Senate Committee on Agriculture, Nutrition,
and Forestry, United States Senate, Washington, D.C.

Dear Mr. Chairman:

We thank you for agreeing to hold hearings so expeditiously on problems of the Farm Credit System. Since the hearing date was announced, the Administration has asked for a delay in order to review Farm Credit third quarter financial figures, which will be available by October 23. While the situation is extremely urgent, to postpone the hearing for a short time in order to have the most current numbers available for consideration is a reasonable and sound request, and one with which we concur.

We look forward to hearing from your staff on this and if we can be of any assistance in the meantime, please advise us.

Again, we thank you for your consideration.

Most sincerely,

DELMAR K. BANNER.

THE 37 FARM CREDIT BANKS

UNAUDITED COMBINED CONDENSED FINANCIAL STATEMENTS AND FINANCIAL COMMENTARY

SEPTEMBER 30, 1985

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF CONDITION

(In Thousands of Dollars)

	September 30, 1985 (Unaudited)	December 31, 1984
Assets		
Loans, less allowance for loan losses of $1,089,025 and $668,898, respectively	$70,741,647	$77,088,964
Investment securities and cash	5,294,328	3,415,765
Total earning assets	76,035,975	80,504,729
Accrued interest receivable on loans	3,169,813	3,480,223
Premises, equipment and other assets less accumulated depreciation	630,323	525,448
Other property owned	694,138	321,138
Total assets	$80,530,249	$84,831,538
Liabilities and Capital		
Consolidated systemwide bonds	$56,055,114	$62,071,356
Consolidated bank and other bonds	4,770,723	5,231,095
Consolidated systemwide notes	7,461,434	4,890,051
Other liabilities	3,700,123	3,396,687
Total liabilities	71,987,394	75,589,189
Capital stock and participation certificates	4,916,260	5,140,829
Surplus	3,626,595	4,101,520
Total capital	8,542,855	9,242,349
Total liabilities and capital	$80,530,249	$84,831,538

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF CHANGES IN CAPITAL

(In Thousands of Dollars)

	For the 9 Months Ended September 30,	
	1985	1984
	(Unaudited)	
Beginning balance	$9,242,349	$8,969,381
Net income (loss) for the period	(426,255)	363,070
Capital stock and participation certificates issued	216,012	264,530
Capital stock, participation certificates, and surplus retired	(489,251)	(313,350)
Balance at September 30	$8,542,855	$9,283,631

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF CHANGES IN FINANCIAL POSITION

(In Thousands of Dollars)

	For the 9 Months Ended September 30,	
	1985	1984
	(Unaudited)	
Financial resources were provided by:		
Net income (loss)	$ (426,255)	$ 363,070
Charges to income not affecting resources:		
Provision for loan losses	675,910	77,407
Depreciation and amortization	22,168	(7,544)
Provision for losses on acquired property	99,504	308
Total provided by operations	371,327	433,241
Consolidated systemwide bonds issued	20,235,454	28,562,886
Consolidated systemwide notes issued, net	2,571,383	702,394
Decrease in loans	5,671,407	-
Decrease in accrued interest receivable	310,410	-
Increase in other liabilities	303,436	192,250
Total	$29,463,417	$29,890,771
Financial resources were used for:		
Consolidated systemwide bonds retired	$26,251,696	$28,869,673
Consolidated Bank and other bonds retired, net	460,372	25,709
Increase in loans	-	204,521
Increase in investment securities and cash	1,862,740	421,623
Increase in accrued interest receivable	-	71,965
Increase in other property owned	472,504	185,697
Additions to premises, equipment and other assets, net	142,866	62,763
Capital stock and participation certificates retired, net	273,239	48,820
Total	$29,463,417	$29,890,771

THE 37 FARM CREDIT BANKS

NOTES TO COMBINED CONDENSED FINANCIAL STATEMENTS
(In Thousands of Dollars)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

The condensed 37 Farm Credit Banks combined financial statements include financial information of the 12 Federal Land Banks, the 12 Federal Intermediate Credit Banks, and the 13 Banks for Cooperatives at September 30, 1985 and for the 3 months and 9 months then ended. The condensed combined financial statements do not include the financial results of the Production Credit Associations and the Federal Land Bank Associations which are chartered under the provisions of the Farm Credit Act of 1971, as amended, but are not directly liable for Farm Credit bonds and notes. A complete description of the Farm Credit System, the accounting policies followed by the Farm Credit Banks, and their financial condition and results of operations as of December 31, 1984 is contained in the **1984 Farm Credit Banks Report to Investors,** available from the Federal Farm Credit Banks Funding Corporation.

The accompanying unaudited quarterly condensed financial statements should be read in conjunction with the **1984 Farm Credit Banks Report to Investors.** These financial statements contain all adjustments considered necessary for a fair presentation of the interim results subject to the resolution of the uncertainty relating to the adequacy of the allowance for loan losses as discussed in Note 3. Certain amounts in prior years' financial statements have been reclassified to conform to current classifications.

NOTE 2 - PROPOSALS FOR FEDERAL GOVERNMENT ASSISTANCE:

The Boards of Directors of the 37 Farm Credit Banks agreed at a meeting in September, 1985 to form a special Legislative Committee to seek Federal government assistance for the purpose of ensuring the System's continued viability. The Legislative Committee is developing proposals for Farm Credit System self-help and Federal assistance which are currently being discussed with the United States Government with a view towards agreeing on solutions for the System's problems.

NOTE 3 - ALLOWANCE FOR LOAN LOSSES:

An analysis of the allowance for loan losses included in the accompanying financial statements for the 3 months and 9 months ended September 30, 1985 and 1984 follows:

	3 Months Ended September 30,		9 Months Ended September 30,	
	1985	1984	1985	1984
Balance at beginning of period	$ 745,141	$673,052	$ 697,533	$665,437

Provision for loan losses	468,983	36,007	675,910	77,407
Loans charged off, net of recoveries	(158,584)	(40,161)	(317,903)	(73,945)
Other	33,485		33,485	
Balance at end of period	$1,089,025	$668,898	$1,089,025	$668,898

The provision for loan losses is based in part on a special credit review of Federal Land Banks which was completed in September, 1985. In addition, the Farm Credit Banks have analyzed agricultural economic conditions and trends and their potential impact on the Banks. This analysis was based upon economic studies conducted by the U.S. Department of Agriculture and the Farm Credit Administration. As a result of projected continuing deterioration in farm income and land values, the Farm Credit Banks may be exposed to loan losses aggregating $3.0 billion or more during the 1985-1987 period for which an allowance for loan losses of $1.089 billion has been established as of September 30, 1985. The Farm Credit Banks will make appropriate additions to the allowance for loan losses in the fourth quarter of 1985 based upon a detailed analysis of the loss exposure in the Banks' individual loan portfolios.

FARM CREDIT BANKS FINANCIAL COMMENTARY--SEPTEMBER 30, 1985

Highlights

Significant financial developments for the three months and nine months ended September 30, 1985 included:

- o The combined Farm Credit Banks incurred net losses of $522.5 million and $426.3 million for the three months and nin months ended September 30, 1985, respectively, compared to net income of $126.4 million and $363.1 million recorded for the same periods in 1984.
- o Total capital of the Farm Credit Banks at September 30, 1985 was $8.5 billion, a decline of $0.7 billion from the December 31, 1984 level.
- o The provision for loan losses for the first nine months of 1985 was $675.9 million; net loan charge-offs during the period amounted to $317.9 million. The provision for loan losses and net charge-offs for the comparable period in 1984 were $77.4 million and $73.9 million, respectively. The allowance for loan losses at September 30, 1985 was $1,089.0 million compared to $745.1 million at June 30, 1985 and $697.5 million at December 31, 1984. As discussed in Note 3 to the accompanying financial statements, the adequacy of the provision and related allowance for loan losses is currently being analyzed.
- o Total risk funds for the 37 Farm Credit Banks, consisting of capital stock, surplus and the allowance for loan losses was $9.6 billion at September 30, 1985 compared to $10.0 billion at December 31, 1984.
- o Net loans outstanding of the Farm Credit Banks were $70.7 billion at September 30, 1985, a decrease of $3.3 billion or

4.4 percent from the amount outstanding at June 30, 1985, and a decrease of $6.3 billion or 8.2 percent from December 31, 1984.

- Farm Credit securities outstanding decreased to $68.3 billion at September 30, 1985, compared to $70.0 billion outstanding three months earlier and $72.2 billion at December 31, 1984.

Commentary

The net loss in the third quarter of 1985 is principally due to the effect of the increase in the provision for loan losses, primarily in the Federal Land Banks (FLBs), and financial assistance provided to Production Credit Associations (PCAs).

The provision for loan losses of $469 million for the three months ended September 30, 1985 and $676 million for the first nine months of 1985 increased from $36 million and $77 million, respectively, during the same periods in the prior year. The combined Farm Credit Banks' allowance for loan losses to loans ratio increased from 1.0 percent at June 30, 1985 to 1.5 percent at September 30, 1985.

The provision for loan losses during the third quarter is directly related to the increase of $1.5 billion in nonaccrual loans which resulted from recognition of potential losses identified in a special credit review of the FLBs completed by the Farm Credit Banks in September 1985, and the resulting reclassification of loans 90 days or more past due, on which interest was being accrued. Consistent with their accounting policies, the Farm Credit Banks are continuing to accrue interest on certain loans which were 90 days or more past due on the basis that they are well accured. The principal balance of such loans at September 30, 1985 was approximately $1.6 billion.

Loans in nonaccrual status increased to $3.5 billion or 4.9 percent of loans outstanding at September 30, 1985 compared to $2.0 billion or 2.7 percent of loans outstanding at June 30, 1985. Other property owned, acquired as a result of loan foreclosures, increased during the third quarter to $694 million at September 30, 1985 from $580 million at June 30, 1985. This increase is due to foreclosure activity and the relative difficulty of selling acquired properties in the saturated farm real estate markets of several districts. Other expenses for the nine months ended September 30, 1985 included a $100 million provision to recognize declines, subsequent to acquisition, in the value of other property owned. Such provision was not significant in the comparable prior period.

The special credit review of the FLBs indicated that approximately $6 billion of the FLBs' $48 billion of loans outstanding are currently undercollateralized to the extent that the loan amounts exceed the current estimated market value of the real estate collateral. As of the date of the review, the amount by which the outstanding balance of these loans exceeded the collateral values approximated $900 million. While many of the undercollateralized loans are now current as to the payment of principal and interest, some are expected to generate significant future losses.

As described in Note 3 to the accompanying financial statements, the Banks may be exposed to aggregate loan losses of

$3.0 billion or more during 1985 and the next two years. System Banks are analyzing their loan portfolios in order to determine whether additions to the allowance for loan losses are necessary.

With respect to the increase in financial assistance to PCAs, the Boards of Directors of the System's Banks approved a financial assistance plan for the FICB of Omaha and its related PCAs in August 1985. Under the plan, the participating Farm Credit Banks made $75 million in loss sharing payments to the FICB of Omaha in September, 1985. The FICB of Omaha contributed the $75 million received from the participating Banks and $50 million of its own funds to its most financially-troubled PCAs. Such amounts were charged to expense in the third quarter. If certain conditions are satisfied, the plan will also require the participating Banks to purchase, through the Farm Credit System Capital Corporation, approximately $240 million of high risk assets of the Omaha District PCAs in late 1985 or early 1986.

Financial difficulties continue to be experienced by PCAs whose results, although not included in the combined Farm Credit Banks' financial statements, have a significant impact on the financial condition of the FICBs. The combined PCAs are expected to incur significant operating losses during 1985 following net losses of $116 million before distribution of FICB earnings in calendar year 1984. PCA combined loan losses for 1985 are projected to be approximately $500 million compared to the 1984 level of $285 million. Due to the severely weakened financial condition of PCAs in several districts, it is possible that additional financial assistance will be required to provided by the respective FICBs during the fourth quarter. In addition, several Farm Credit districts are currently developing plans to merge the PCAs in a district into one or more larger PCAs to centralize management and to pool capital and other resources. Such mergers were approved by the PCA stockholders in the Spokane and Jackson districts during the 1985 third quarter. PCA stockholders in a number of other districts are expected to vote on such merger plans before the end of 1985.

The combined Banks have taken steps to improve their liquidity position, including establishment of a centrally-managed investment pool in which substantially all Banks are participating. Investment securities and cash held by the Banks and in this investment pool at September 30, 1985 increased to $5.3 billion, a 55 percent increase over the December 31, 1984 balance.

The Banks' capital position of $8.5 billion at September 30, 1985 consisted of $4.9 billion of capital stock and participation certificates and $3.6 billion of surplus. The decline of $651 million in total capital since June 30, 1985 is primarily due to the $522 million net loss recorded in the third quarter and net stock retirements resulting from reduced loan volume. As described in the **1984 Farm Credit Banks Report To Investors,** the capital structure of the Farm Credit Banks, as member-owned cooperatives, differs substantially from other commercial financial institutions because the issuance and retirement of capital stock and participation certificates are directly related to the lending activities of the Banks.

THE 37 FARM CREDIT BANKS
COMBINED CONDENSED STATEMENT OF OPERATIONS

(In Thousands of Dollars)

	For the 3 Months Ended September 30,		For the 9 Months Ended September 30,	
	1985	1984	1985	1984
		(Unaudited)		
Interest income				
Interest and other charges on loans	$2,018,966	$2,329,570	$6,383,471	$6,754,733
Interest on investment securities	98,613	79,401	248,781	213,693
Total interest income	2,117,579	2,408,971	6,632,252	6,968,426
Interest expense				
Interest cost of bonds and notes	1,854,258	2,113,130	5,789,172	6,242,836
Interest on notes payable to Associations and others	40,140	45,846	82,174	84,464
Total interest expense	1,894,398	2,158,976	5,871,346	6,327,300
Net interest income	223,181	249,995	760,906	641,126
Provision for loan losses	468,983	36,007	675,910	77,407
Net interest income (loss) after provision for loan losses	(245,802)	213,988	84,996	563,719
Other income				
Loan service fees and other income	46,915	12,464	74,479	96,422
Other expenses				
Salaries, wages and other employee benefits	42,356	38,372	123,542	115,051
Financial assistance to Associations	149,350	-	163,152	-
Provision for losses on acquired property	76,000	1,513	99,504	2,899
Occupancy, equipment and other operating expenses	22,192	28,084	85,081	83,275
Compensation to Associations for originating and servicing loans	33,694	32,052	114,451	95,846
Total other expenses	323,592	100,021	585,730	297,071
Net income (loss)	$ (522,479)	$ 126,431	$ (426,255)	$ 363,070

Outlook

Agricultural economists, both within and outside the Farm Credit System project that current negative trends in the U.S. agricultural economy will continue in the near term. Accordingly, significant increases in non-earning assets and loan losses are expected through the remainder of 1985 and the next two years. Based upon the economic projections referred to above, the Farm Credit System may have to deal with non-earning assets aggregating more than $10 billion over the next several years. Competitive pressures and the weakened financial condition of the System's borrowers may preclude the Banks from increasing interest rates to offset the factors having negative effects on the combined Banks' earnings.

In reflecting new information concerning the System's loan portfolio in the third quarter results, the Banks' early September estimate of the possible operating loss for calendar year 1985 was exceeded during the first nine months. Additional losses are anticipated during the fourth quarter of 1985. However, the magnitude of such losses is dependent upon the resolution of the uncertainties discussed above with respect to the adequacy of the Banks' allowance for loan losses. System officials are presently discussing with representatives of the United States government proposals to address the System's problems through the utilization of the System's own resources and Federal assistance.

THE 37 FARM CREDIT BANKS
SELECTED FINANCIAL RATIOS

	For the 3 Months Ended September 30,		For the 9 Months Ended September 30,	
	1985	1984	1985	1984
Return on average assets	(2.57)%	0.59%	(0.69)%	0.57%
Return on average capital	(23.57)	5.47	(6.27)	5.31
Net interest income as a percent of average earning assets	1.16	1.22	1.29	1.05
Net charge-offs to average loans	0.87	0.20	0.56	0.12

	September 30, 1985	December 31, 1984
Allowance for loan losses to loans	1.52%	0.90%
Capital to loans	11.89	11.88
Debt to capital (:1)	8.43	8.18

[News Release, October 23, 1985]

FARM CREDIT BANKS ANNOUNCE THIRD QUARTER AND NINE MONTHS RESULTS

NEW YORK, Oct 23, 1985 -- Peter J. Carney, President of the Federal Farm Credit Banks Funding Corporation, announced today the third quarter and nine months 1985 unaudited financial results for the combined 37 Farm Credit Banks:

Financial Highlights

Significant financial developments for the three months and nine months ended September 30, 1985 included:

- The combined Farm Credit Banks incurred net losses of $522.5 million and $426 million for the three months and nine months ended September 30, 1985, respectively, compared to net income of $126.4 million and $363.1 million recorded for the same periods in 1984.
- Total capital of the Farm Credit Banks at September 30, 1985 was $8.5 billion, a decline of $0.7 billion from the December 31, 1984 level.
- The provision for loan losses for the first nine months of 1985 was $675.9 million; net loan charge-offs during the period amounted to $317.9 million. The provision for loan losses and net charge-offs for the comparable period in 1984 were $77.4 million and $73.9 million, respectively. The allowance for loan losses at September 30, 1985 was $1,089.0 million compared to $745.1 million at June 30, 1985 and $697.5 million at December 31, 1984. As discussed below, the adequacy of the provision and related allowance for loan losses is currently being analyzed.
- Total risk funds for the 37 Farm Credit Banks, consisting of capital stock, surplus and the allowance for loan losses was $9.6 billion at September 30, 1985 compared to $10.0 billion at December 31, 1984.
- Net loans outstanding of the Farm Credit Banks were $70.7 billion at September 30, 1985, a decrease of $3.3 billion or 4.4 percent from the amount outstanding at June 30, 1985, and a decrease of $6.3 billion or 8.2 percent from December 31, 1984.
- Farm Credit securities outstanding decreased to $68.3 billion at September 30, 1985, compared to $70.0 billion outstanding three months earlier and $72.2 billion at December 31, 1984.

Proposals For Federal Government Assistance

The Boards of Directors of the 37 Farm Credit Banks agreed at a meeting in September 1985 to form a special Legislative Committee to seek Federal government assistance for the purpose of ensuring the Farm Credit System's continued viability. The Legislative Committee is developing proposals for System self-help and federal assistance which are currently being discussed with the United States Government with a view towards agreeing on solutions for the System's problems.

Financial Commentary

The net loss in the third quarter of 1985 is principally due to the effect of the increase in the provision for loan losses, primarily in the Federal Land Banks (FLBs), and financial assistance provided to Production Credit Association (PCAs).

The provision for loan losses of $469 million for the three months ended September 30, 1985 and $676 million for the first nine months of 1985 increased from $36 million $77 million, respectively, during the same period in the prior year. The combined Farm Credit Banks' allowance for loan losses to loans ratio increased from 1.0 percent at June 30, 1985 to 1.5 percent at September 30, 1985.

The provision for loan losses during the third quarter is directly related to the increase of $1.5 billion in nonaccrual loans which resulted from recognition of potential loan losses identified in a special credit review of the FLBs conducted by the Farm Credit Banks which was completed in September 1985, and the resulting reclassification of loans 90 days or more past due, on which interest was being accrued. Consistent with their accounting policies, the Farm Credit Banks are continuing to accrue interest on certain loans which were 90 days or more past due on the basis that they are well secured. The principal balance of such loans at September 30, 1985 was approximately $1.6 billion.

Loans in nonaccrual status increased to $3.5 billion or 4.9 percent of loans outstanding at September 30, 1985 compared to $2.0 billion or 2.7 percent of loans outstanding at June 30, 1985. Other property owned, acquired as a result of loan foreclosures, increased during the third quarter to $694 million at September 30, 1985 from $580 million at June 30, 1985. This increase is due to foreclosure activity and the relative difficulty of selling acquired properties in the saturated farm real estate markets of several districts. Other expenses for the nine months ended September 30, 1985 included a $100 million provision to recognize declines, subsequent to acquisition, in the value of other property owned. Such provision was not significant in the comparable prior period.

The special credit review of the FLBs indicated that approximately $6 billion of the FLBs' $48 billion of loans outstanding are currently undercollateralized to the extent that the loan amounts exceed the current estimated market value of the real estate collateral. As of the date of the review, the amount by which the outstanding balance of these loans exceeded the collateral values approximated $900 million. While many of the undercollateralized loans are now current as to the payment of principal and interest, some are expected to generate significant future losses.

The Farm Credit Banks have analyzed agricultural economic conditions and trends, and their potential impact on the Banks. This analysis was based upon economic studies conducted by the U.S. Department of Agriculture and the Farm Credit Administration. As a result of projected continuing deterioration in farm income and land values, the Farm Credit Banks may be exposed to loan losses aggregating $3.0 billion or more during the 1985-1987 period for which an allowance for loan losses of $1.089 billion has been established as of September 30, 1985. The Farm Credit Banks will make appropriate additions to the allowance for loan losses in the fourth quarter of 1985 based upon a detailed analysis of the loss exposure in the Banks' individual loan portfolios.

With respect to the increase in financial assistance to PCAs, the Boards of Directors of the System's Banks approved a financial assistance plan for the FICB of Omaha and its related

PCAs in August 1985. Under the plan, the participating Farm Credit Banks made $75 million in loss sharing payments to the FICB of Omaha in September 1985. The FICB of Omaha contributed the $75 million received from the participating Banks and $50 million of its own funds to its most financially-troubled PCAs. Such amounts were charged to expense in the third quarter. If certain conditions are satisfied, the plan will also require the participating Banks to purchase, through the Farm Credit System Capital Corporation, approximately $240 million of high-risk assets of the Omaha District PCAs in late 1985 or early 1986.

Financial difficulties continue to be experienced by PCAs whose results, although not included in the combined Farm Credit Banks' financial statements, have a significant impact on the financial condition of the FICBs. The combined PCAs are expected to incur significant operating losses during 1985 following net losses of $116 million before distribution of FICB earnings in calendar year 1984. PCA combined loan losses for 1985 are projected to be approximately $500 million compared to the 1984 level of $285 million. Due to the severely weakened financial condition of PCAs in several districts, it is possible that additional financial assistance will be required to be provided by the respective FICBs during the fourth quarter. In addition, several Farm Credit districts are currently developing plans to merge the PCAs in a district into one or more larger PCAs to centralize management and to pool capital and other resources. Such mergers were approved by the PCA stockholders in the Spokane and Jackson districts during the 1985 third quarter. PCA stockholders in a number of other districts are expected to vote on such merger plans before the end of 1985.

The combined Banks have taken steps to improve their liquidity position, including establishment of a centrally-managed investment pool in which substantially all Banks are participating; investment securities and cash held by the banks and in the investment pool at September 30, 1985 increased to $5.3 billion, a 55 percent increase over the December 31, 1984 balance.

The Banks' capital position of $8.5 billion at September 30, 1985 consisted of $4.9 billion of capital stock and participation certificates and $3.6 billion of surplus. The decline of $651 million in total capital since June 30, 1985 is primarily due to the $522 million net loss recorded in the third quarter and net stock retirements resulting from reduced loan volume. As described in the **1984 Farm Credit Banks Report To Investors,** the capital structure of the Farm Credit Banks, as member-owned cooperatives, differs substantially from other commercial financial institutions because the issuance and retirement of capital stock and participation certificates are directly related to the lending activities of the Banks.

The Outlook

Agricultural economists, both within and outside the Farm Credit System, project that current negative trends in the U.S. agricultural economy will continue in the near term. Accordingly, significant increases in non-earning assets and loan losses are expected through the remainder of 1985 and the next two years. Based upon the economic projections referred to above, the Farm Credit System may have to deal with non-earning assets aggregating more than $10 billion over the next several years. Competitive pressures and the weakened financial condition of the System's borrowers may preclude the Banks from increasing interest rates to offset the factors having negative effects on the Banks' earnings.

In reflecting new information in the third quarter results, the Banks' early September estimate of the possible operating loss for calendar 1985 was exceeded during the first nine months. Additional losses are anticipated during the fourth quarter of 1985. However, the magnitude of such losses is dependent upon the resolution of the uncertainties discussed above with respect to the adequacy of the Banks' allowance for loan losses. System officials are presently discussing with representatives of the United States government proposals to address the System's problems through the utilization of the System's own resources and Federal assistance.

Copies of the unaudited financial statements of the combined 37 Farm Credit Banks for the three months and nine months ended September 30, 1985 are presently available from the Federal Farm Credit Banks Funding Corporation. Price Waterhouse has been engaged to audit the financial statements of the combined 37 Farm Credit Banks for the year ending December 31, 1985. Price Waterhouse has not audited the interim financial statements for the nine months ended September 30, 1985.

The Farm Credit System is a nationwide system consisting of borrower-owned financial institutions organized as cooperatives. The System is made up of 12 Federal Land Banks which make long-term loans through Federal Land Bank Associations; 12 Federal Intermediate Credit Banks which provide short-term and intermediate-term credit to Production Credit Associations and other qualified institutions serving agricultural producers; 13 Banks for Cooperatives which make loans to agricultural, aquatic and rural electric cooperatives, and provide financial services to exporting cooperatives.

STATEMENT OF HON. RUDY BOSCHWITZ
A U.S. SENATOR FROM MINNESOTA

Cash flow is the root problem of agriculture. And most farmers with cash flow problems also have credit problems. They have too much debt and their interest rates are too high.

I believe the credit problem of agriculture is far more easily solved than determining the right course for the 1985 Farm Bill and all the complications related to that. Also, farm credit is a much cheaper problem to solve.

Weather, world markets, currency values, general economic conditions among consuming, and those many other variables don't exist here. The amount of debt, who holds it, where the trouble is, and the cost of fixing it is far more easily defined. Admittedly, interest rates are unpredictable, but they seem like a fairly stable element at the moment and should be predictable within a reasonable range in the near term.

If we could ease farm credit problems, we would go a long way in restoring the confidence of rural America.

THE FARM DEBT

...amounts to about $215 billion. Of this, 112 is a long-term debt secured by real estate, and 103 is short-term, non-real estate debt. Note how the total debt has grown:

1960	$24.8 billion
1965	$36.8 billion
1970	$53.0 billion
1975	$81.8 billion
1980	$157.3 billion
1985	$215.0 billion

How did this happen, you ask? About the same way consumer debt and loans to foreign countries occurred, I suppose. Inflation rates exceeded interest rates, interest payments are tax deductible, and there was a pervasive psychology that inflation was with us to stay, all of which led to lots of bad advice that many people took! Amazingly, however many farmers didn't and a large group of farmers is still debt free. The 1970s sure represent a convincing argument for stable, fairly conservative, and most of all, consistent economic policies.

I approach the ag credit problem -- like most credit difficulties -- with the assumption that the borrower and lender both were willing to make the original deal. In that light, they should share as much of the responsibility for fixing the credit problem as possible (and I must tell you I was personally among the borrowers of the 70s -- though not agricultural loans). That doesn't mean for a moment that there is not a public, as well as practical interest, for the taxpayer. If the ag economy sees a cascading rate of failures due to overburdened credit, the taxpayer and the nation will be assessed in many ways -- not the least of which will be through FDIC guarantees.

WHO HOLDS THE FARM DEBT

Of the $215 billion of debt, it breaks down roughly as follows (by percentage):

	Short-term	Long-term
Commercial Banks	37.9	8.4
Insurance Companies	--	11.4
Individuals/others	18.4	29.0
CCC	10.5	--
Farmers Home (FmHA)	14.2	8.3
The Farm Credit System:		
Production Credit Assn (PCA)	19.0	--
Federal Land Bank (FLB):	--	43.0
TOTAL	100%	100%

The question of "who holds the farm debt" is broken down by geographic area on the attached sheets. The geographic areas are the 12 Farm Credit System Districts and each state is identified. Also, the percentage of the total national farm debt found in each district is shown. As you will notice, the St. Paul District (which includes Minnesota, North Dakota, Michigan and Wisconsin) and the Omaha District (which includes Nebraska, Iowa, South Dakota and Wyoming) have the largest share of total debt -- together holding over 37 percent of the total real estate debt, and over 27 percent of the total non-real estate debt.

Clearly, the solution to the debt crisis varies with the type of loan and lender.

THE FARM CREDIT SYSTEM (FCS)

(A brief description)

The Federal Land Bank (FLB) is the largest element of the FCS. It makes long-term real estate loans, and on December 31, 1984, had 653,373 loans outstanding, totaling $50.9 billion. The FLB rates are not fixed but largely reflect its cost of money. Its rates were below market in the late 70s, which helped drive up land prices.

The Production Credit Associations (PCAs) make short-term loans. On December 31, 1984, 312,680 loans were outstanding, totaling $17.9 billion.

The Bank for Cooperatives had outstanding loans of $8.9 billion to 3,313 coops on December 31, 1984.

Loan levels of all these banks is down in 1985. In fact, their loan volume has declined nearly $4 billion in the past three months.

Interestingly, I am told that the capital structure of the FCS still remains stronger as a percentage of assets than the banking system. The capital of the FCS is developed through profits and the farmer borrower must purchase stock in the FLB or PCA equal to 5 percent of his loan. So, the Farm Credit System's problems are not really capital related, rather they are problems of liquidity.

The FCS obtains its money on the open market. While the federal government loaned the money to the FCS to get it started 50 years ago, this has long since been repaid and the federal government has no present liability on any loans made to or by the FCS.

The Farm Credit Administration (FCA) is an administrative oversight body, but with very little authority. This needs to be corrected. All elements of the FCS are interrelated and are thought to be responsible for each other's debts. While this is technically correct, it needs better definition. That better definition and the expansion of the authority of the FCA needs to be part of the package when aid is extended to the Farm Credit System.

WHAT TO DO ON FARM CREDIT

A. Credit held by other individuals - individuals holding debt from other individuals have considerable flexibility and don't have bank examiners peering over their shoulders. The imputed interest rates to 6 percent (non-family transactions 9 percent) and, of course, principal payments can be entirely rescheduled. To increase flexibility for non-family transactions, I would favor lowering the imputed rates to 6 percent for a 5-year period.

B. Credit extended by banks and the Farm Credit System - I believe we need a program that targets assistance to the family-sized commercial farmers. They make up about one-third of all the farmers -- but hold nearly 65 percent of the total farm debt. According to the Federal Reserve, about $33 billion of this debt -- or nearly one-fourth -- is in trouble.

I recently outlined a plan to ease credit problems for these farmers and their creditors -- both the Farm Credit System and the banks. To be eligible, farmers must have gross annual sales of at least $30,000 and a debt to asset ratio exceeding 40 percent. The program is targeted to the family-sized commercial farmer, and these individuals clearly need the lion's share of the assistance.

The program would last three years and we could take a new reading at that time. To participate in the program, banks and the FCS must do so within one year of enactment of the program.

The problem would run as follows:

1. Eligibility - commercial banks and the FCS would be eligible,farmers with gross annual sales of at least 30,000 and a debt to asset ratio exceeding 40 percent. The program is targeted to the family-sized commercial farmer, where one-third of the group (10 percent of all farmers) holds 45 percent of all outstanding ag debt.

2. Length of Program - three years; we can take a new reading at that time. To participate in the program, banks and the FCS must do so within one year of enactment.

3. Interest Rate Buydown - up to 5 percent for the three years to be borne by the federal government, states and the lender in the ratio of 2-2-1.

   State participation is optional. The interest rate reduced could not exceed a fixed percentage over the Treasury's cost of money. The federal government's 2 percent would cost up to 1.3 billion per year.

4. Principal Forgiveness - up to 30 percent, and the banks would be allowed to write it off over 10 years so their capital structure wouldn't be undermined (if the bank writes the principal down by 15 percent or more, it would not have to also take the 1 percent interest hit). Bankers have

indicated to me that they would be willing to forgive up to this much under the restructuring program.

C. If the loan is FCS loan and if after the interest buydown and 30% principal reduction, the farmer is still unable to make his payments, then his loan can be transferred to the recently-established FCS Capital Corporation and warehoused there for up to 5 to 10 years. The title to the farm will be taken into the Capital Corporation which can lease it back to the farmer who has the option to repurchase the land at the end of the warehouse period at what is the market price at that time. The FCS will make maximum use of each of the system's districts reserves to take care of its own losses. But, after all these reserves have been used up. As certified by the new Farm Credit Systems regulator then we would allow them in effect to "sell" their restructured loss to the Capital Corporation, in return for a promissory note. This could occur both in the case of a title transfer or a simple principal write down.

The funds needed to carry this remaining loss will be provided by the federal government which the FCS can pay back over the years as it did with the capital it originally received from the Federal Government. (This was all repaid by the mid 1960s.)

Then, when the Federal government steps out of the picture at the end of the three years, the Farm Credit System will become liable for the debts of the capital corporation -- and the system's banks will be responsible on a loan volume per capita share for the repayment of the government's loans.

The net effect of all this is that the loss, and the responsibility for the carrying cost of the loss, is removed from the FCS districts that have insufficient reserves to be able to handle it on a local level, but is left with those districts that have reserves. The responsibility then lies with the capital corporation, and the federal government will help with the financing for the first 3 years.

The Farmers Home Administration (FmHA) has many tools to assist farmers. However, if commercial banks and the FCS can refuse credit to their existing borrowers and thereby force them on to the FmHA, which then makes that farmer a loan, the proceeds of which pay off the bank -- well, if that can continue, no banks of which pay off 30 percent of the principal or 1 percent of the interest. It will just let Uncle Sam (the FmHA) eat all its bad loans. I want to keep as many farmers as possible with their local banks and FCS offices.

CONCLUSION

Banks and other lenders can do much on their own to lighten the debt burden of their customers -- and they are already doing it in many creative ways (particularly rescheduling or laying aside principal payments). But if the government can add to their bag of tricks by: 1) improving imputed interest rules in non-family transactions; 2) buying down interest up to 5 percent; 3) providing a means to adjust principal up to 30 percent;

and 4) also clearing an avenue to collect and strengthen (if necessary) the capital of the Farm Credit System, we would do mush to improve the nation's agricultural debt situation.

One important extra benefit of improving the credit system is that overall interest rates to farmers could -- and likely would -- fall. That would break the economic stranglehold interest payments have put on many farmers. This would be a giant step in restoring confidence on the main streets and among farmers of rural America.

STATEMENT OF HON. MITCH McCONNELL
A U.S. SENATOR FROM KENTUCKY

This series of hearings on the Farm Credit System will be as important as any hearings this Committee has conducted this year. With over $70 billion in farm debt nationwide, the viability of the System is critical if we are to maintain some semblance of order in the complicated mess that is farm credit today.

The fourth Credit District of the Farm Credit System covers 4 states, including Kentucky. The Fourth Credit System isn't broke yet, but they're fast headed in that direction and that is why this hearing is so critical to the farmers of Kentucky. With a total loan volume of $5.1 billion, the Farm Credit System is such an important part of Kentucky agriculture that the impact of the collapse of the System would be virtual depression in rural Kentucky. As bad as things are, Mr. Chairman, we simply can't let them get any worse.

The background for the Farm Credit System's troubles are well documented; low crop and livestock prices, declining land values, and over-leveraged farmers are all factors in the equation. But some of the blame must be borne by the Farm Credit Administration itself. Let me explain myself on this point, Mr. Chairman.

Before the August recess, I was briefed by officials of the System so that I could respond to the concerns of Kentucky farmers regarding the problems of the Farm Credit System. I was told that, yes there is certainly some stress in the System, but we believe that we have the resources to ride out the storm. They were very confident in this belief and brought a stack of papers about an inch thick which proved that the financial resources were there so that federal assistance for the System wouldn't be needed.

So armed with these figures, I headed to Western Kentucky where I heard a vastly different story. Farmers spoke of Farm Credit policy where forebearance for struggling farmers in this time of farm economic stress was the exception rather than the rule. I heard of lending practices where Federal Land Bank and Production Credit Association officials flagged down farmers out of the fields in the early 1980's to encourage to borrow more money, regardless of need. I heard of hefty salary increases for Farm Credit officials despite the fact that loan volume and loan repayments were dropping at alarming rates.

But what may have been most alarming, Mr. Chairman, was the dim outlook expressed by many farmers about the future of the Farm Credit System, a System in which many farmers had invested thousands of dollars in System stock. And these farmers told stories of their neighbors, who were in the financial position to do it, leaving the system en masse and obtaining credit from other institutions. In other words, the most solid borrowers were jumping ship, leaving the most hard-pressed farmers holding the bag for some poor management decisions made by officials who should have known better.

And then what did I hear EVEN BEFORE WE GOT BACK TO WASHINGTON? The Governor of the Farm Credit System publicly admits that short of massive federal assistance, the System may not be able to survive. What a revelation! My farmers knew this 2 or 3 years ago.

Mr. Chairman, I don't want this to turn into a political football. But we need some solid options from the administration, the System and from members of this Committee and this Body, so that we can maintain an element of the agricultural structure which is critical to the long term stability of agriculture. We need to maintain the integrity of Farm Credit System bonds on the New York bond markets, but we almost must remember that the Farm Credit System was established to serve farmers.

I am working closely with my good friend Senator Boschwitz to adopt comprehensive farm credit legislation which will serve farmers in the short run and begin to rebuild investor faith in the Farm Credit System. I know others have offered initiatives in an effort to accomplish the same goals. We must act and act quickly if we are to spare rural America from the pain of collapse of this institution.

Mr. Chairman, we've helped New York City get back on its feet; we've helped Lockheed get back on its feet; we've helped Chrysler get back on its feet; and more recently, we've helped Continental Bank of Illinois stay in business. I don't think America's farmers are any less important.

Thank you Mr. Chairman.

STATEMENT OF HON. TOM HARKIN
A U.S. SENATOR FROM IOWA

Mr. Chairman, thank you for this opportunity to speak briefly on the crisis confronting the Farm Credit System.

The situation continues to deteriorate throughout the heartland. A substantial percentage of our farmers in my home state of Iowa, as many as one-third by recent estimates, are on the brink of insolvency.

Farm income continues to decline as the real prices received by our farmers are at or near record lows for all the principal commodities produced in Iowa -- corn, soybeans, cattle and hogs.

Farmland values, which according to USDA data have declined 49 percent since 1981, continue to decline as more and more land is forced onto the market and prospective buyers sit on the sidelines waiting for land values to decline even further.

In short, we're dying in Iowa.

We have heard and continue to hear about the need for a massive bailout of the Farm Credit System. To be sure, if that system collapses a financial crisis of monumental proportions will be felt from Main Street all the way to Wall Street.

As the Congress strugles to formulate policies to put the Farm Credit System Back on financial footing we need to keep sight on why we have this crisis - our farmers are not making enough on their crops to make it.

And, if we only treat the symptoms but we don't go to the heart of the problem, if we don't do anything to get farm income up, we will face this same crisis again next year and the year after and every until we make meaningful changes in farm policy.

Until this Congress and this administration changes the failed farm policies of the past several years we will simply be spending good money after bad.

I would also submit that it would be bad policy to provide assistance to the Farm Credit System without helping our farmers first. It will also be bad policy to ignore the very serious problems our commercial lenders are having in the farmbelt.

Whatever course we choose to take, our actions must be "farmer first."

At the very heart of the farm credit crisis has been the disastrous decline in farmland values.

Several alternative solutions have been proposed. Some would have us form a new lending entity - something like an Aggie Mae - that would take ownership of agricultural lands and reduce farmers to renters or sharecroppers.

Another proposed solution is to provide several billion dollars to the Farm Credit System to enable them to use a newly formed corporation to purchase non-performing loans and in all likelyhood, liquidate them.

Both of these are equally bad for family farmers. Both would separate farmers from their land and have the potential for further reductions in land values. These are not solutions for farmers...they would in fact, sell our farmers out.

I have introduced legislation to address the farm credit crisis. I believe that any legislative remedy must encompass these key elements:

--Land prices must be stabilized and we must prevent the Farm Credit System, banks and their regulators from devaluing the value of land below its income producing value or cash flow value.

--Our first priority in dealing with the farm credit crisis should be to directly aid family farmers, not to bail out the bond holders or agricultural lenders in general.

--Any solutions must not require farmers to give up title to their land as a condition for assistance.

--We cannot and must not limit our assistance to borrowers of the Farm Credit System. In my state, a number of banks are failing or are having severe problems.

--All parties (the government, the lender, and the farmer himself) must be required to contribute to the solution.

--Finally, this legislation should not require the creation of a new government entity.

The time is here to seriously address the credit crisis. But if we try to solve the problem without first getting our farmers back on their feet, we will be doing little more than applying expensive bandaids when major surgery is needed.

STATEMENT OF HON. PETE WILSON
A U.S. SENATOR FROM CALIFORNIA

Mr. Chairman, I wish to commend you for holding this hearing on the financial condition of the Farm Credit System. It is a matter of critical importance to American agriculture and of keen interest, no doubt, to our agricultural competitors abroad.

I believe that the agenda before each of us this week is reflective of the crisis confronting our nation's farmers. We are in the middle of extensive debate on the floor of the Senate attempting to craft a four-year farm bill to ensure the long-term health of American agriculture. And we have temporarily set-aside that matter, so that we can focus on the ailments afflicting the structure which finances the farmers.

Earlier this year during the planting season, we debated the best way to provide short-term credit assistance to financially-stressed farmers. Although the various proposals would have applied nationwide, there existed a perception that the credit problem was especially harsh in the Midwest.

I must admit that I shared that perception 10 months ago; however, subsequent events and discussions have convinced me that the credit crisis is national in scope. I believe that the testimony presented here, today, will confirm the geographic breadth of the problem.

Throughout the summer months, I visited with farmers and agricultural lenders throughout California and have seen land values and farm income plummet. I have driven through the usually lush San Joaquin Valley and viewed acre after acre of abandoned vineyards which are not even generating enough cash to justify maintenance. Land which sold for between $12,000 and $15,000 an acre is for sale at $3,000. I am sure that the rest of my colleagues on the Committee have encountered similar developments in their states, as well.

The potential dimension of the problem is staggering, and a financially strong Farm Credit System is an important component of any federal solutions. However, it is just one component of our agricultural lending structure. I am equally concerned about the Farmers Home Administration and all the commercial lenders who finance our farmers. These commercial banks, hold 40% of the Farm Credit System's securities.

I believe that an effective federal response to the credit crisis must not only address financial and structural reforms of the Farm Credit System, but must take into consideration any ramifications on and the need for reforms of FmHA and commercial banks.

Once again, Mr. Chairman, I commend you for holding this hearing and am looking forward to the testimony. Thank you.

STATEMENT OF HON. MAX BAUCUS
A U.S SENATOR FROM MONTANA

Mr. Chairman, I want to congratulate you and your colleagues for finding the time to hold these hearings this week even with action on the farm bill. I know you have a great many witnesses, and I don't want to take much of this Committee's time.

Each of you knows as well as I the terrible credit crunch and debt burden confronting the American Farmer. I will not take up the Committee's time with a recitation of the figures.

I come here today to urge the Committee to address not only the short-term crisis in farm credit but also the longer-term question of how to restructure the Farm Credit System.

Whatever we in Congress do to address the short-term problem structural reforms will be necessary to assure the long-term viability of the Farm Credit System. I believe those reforms must address the basic confidence problems plaguing the system: the lack of confidence in the capital markets and the lack of confidence by borrowers.

We must design a system that provides both discipline and local control. The Farm Credit System was created as a cooperative farmer-owned and locally-controlled system. We should be careful not to lose the strengths provided by this cooperative structure.

The bill I have introduced, S. 1790, offers a comprehensive approach to this long-term problem. It replaces the Farm Credit Administration with a true insurance and regulatory agency along the lines of the FDIC and similar federal agencies.

Into this central regulatory agency -- the Federal Farm Credit Insurance Corporation -- would flow approximately half the reserve assets from present system institutions. The bill requires the use of generally accepted accounting principles by the System's banks and PCAs, annual audits, and annual publication of financial statements. Equally important, I believe, the bill retains and strengthens the cooperative nature of the system.

The importance of this cannot be overemphasized. Total abandonment of local control would overturn the grassroots nature of this credit system. I believe -- as do most members of this Committee -- that would be a terrible loss.

The Administration has finally announced a position on assisting the Farm Credit System. I applaud their recognition of the need for a true arm's length financial regulator. But when I look at the Administration's proposal one question jumps out:

Where's the farmer? Where's the
Borrower-shareholder?

The Administration seems to have forgotten the history of this system: a history of local control and of cooperative effort. We should not give that up. I don't think creating an all-powerful central bank holding company is the answer to the farm credit system's problem.

Mr. Chairman, I will not take up more of the Committee's time. You have witnesses scheduled today who can talk to you about actual experiences with the system. I urge this Committee to tackle both the short-term crisis and the longer-term structure of the Farm Credit System. I believe my bill, S. 1790, offers a framework for restructuring the system, and I urge the Committee to consider it.

We owe our farmers a sound and well-run Farm Credit System.

STATEMENT OF HON. CHARLES GRASSLEY
A U.S. SENATOR FROM IOWA

Mr. Chairman, I appreciate this opportunity to testify before the Senate Agriculture Committee. The issue you are considering today is vital to the future of rural America. If we don't do something to shore up the seriously deteriorating situation in the Farm Credit System, agriculture will certainly take a turn for the worse. It should be clear that financial help is necessary for the system but we in Congress should make sure that this money goes to help the farmer and not just the system.

If there is one thing I have discovered from my many conversations and meetings with Farm Credit System officials, farmers, and responsible outside observers, is that the farm credit system's policies are not working. Not only are their policies not working but they are actually making the situation worse.

The policies the Farm Credit System is implementing today are hurting the farmer, destroying the system, and in the near future will cause tremendous expense to the rest of the economy. The Farm Credit System was created during the last depression in agriculture to serve the family farmer. On September 6th of this year I held a hearing regarding the farm credit system. During that hearing testimony proved overwhelmingly, that the Farm Credit System has taken on an identity of its own, separate from it's own stockholders. Even the president of the Farm Credit Banks of Omaha admitted, in the hearing I held, that their policies don't work in times like these. The system believes that it has the power to do whatever it wants and not answer to it's boards of directors, it's membership, and least of all, to the Congress.

The system's lack of responsiveness has been proven everyday by their actions. We know, for example, that the Farm Credit Banks of Omaha intend to call 2000 of it's 16,000 production credit association loans. This is 12.5% of all their PCA loans and is 4 to 5 times as many loans as are already in bankruptcy or acquired property. I have heard reports from concerned officials within the system that some PCAs will be liquidating as much as 30% of their borrowers. These statistics do not even include the loans that will be called by the Federal Land Banks, or that are or will be called by the Federal Intermediate Credit Banks and the Capital Corporation.

I have received many calls from bankers stating that they are very concerned about the direction the system is taking. They say that they can't stand idly by and watch their assets be eaten up by the Farm Credit System. So now these commercial bankers feel they need to foreclose or hold credit away from farmers who deal with the system. We can add to this chaos the Farmers Home Administration, insurance companies, and others who are being forced to call loans and continue the panic. This is a dangerous deteriorating situation that requires drastic action before events get anymore out of control. If we don't do something quickly, we may have only seen the tip of the iceberg.

Mr. Chairman, I know what the Farm Credit System officials will say. They will say, "we are only reacting to the situation they are in". They will say, "that they are the victims not the culprits". To some extent they are right, they are victims of bad government policy just as the farmers and all of Rural America have been. But they are also the cause of many of our problems and they are definitely accelerating the decline. In the last 13 months the members of the Federal Land Bank in my district have watched interest rates go up one and three quarters percent. Higher interest rates cause the farmers expenses to increase and even more significantly cause their assets to decline. These higher interest rates turn cash flowing farmers into bankrupt farmers and only serves to dump more assets on the market. This not only destroys the farmer but it also hurts the system. The system takes the loss on the loan, the loss on the land values, and the loss of an otherwise good customer.

In any other industry the government would classify the Farm Credit System as a monopoly. They control one-third of all agricultural debt. They could use this control to either stabilize the crisis, as they did in the last depression, or to destabilize it further. Unfortunately, today they are heading down the road to destroying stability in agriculture. The system through it's policies is causing an erosion of their customer base, a deterioration in capital, an increase in expenses, and the most significant issue of all, they are causing a complete loss of hope in the future for their stockholders.

Many might say that I am making an emotional plea and they would be right, but I am also making an economic argument. Farmers who lose any hope of surviving don't make payments and give back their farms to their lenders. This causes the Farm Credit System's situation to deteriorate even faster. In addition to these losses, many farmers are leaving the system for "greener" financial pastures. It is clear that the system's policies are leaving the farmers in the middle, the ones that are not rich enough to get out and not poor enough to quit, to pay the price. By doing this the system is forcing these farmers in the middle to take one more step closer to quitting themselves.

Not a day goes by that I don't receive phone calls from farmers who are being harassed by the system. Many of these farmers are only 30 or 60 days late on their payments. Some of these farmers are being foreclosed on despite the fact that they offered to make their payments. It is quite obvious, from all the research we have done, that the farmers confidence in the system has virtually disappeared.

It does not make any sense to go through all the expense of liquidating these farmers, when they may become income producing customers after congressional assistance. The system admits that foreclosures and liquidations are expensive. During my hearing it was revealed that liquidation costs on real estate is minus 25% to 35% from the present market value, which is 50% below land values of just 4 years ago. Liquidation costs on machinery is minus 25%, on grain and livestock is minus 25%, and on hay and silage is minus 65%. It is simply bad business to foreclose on farmers today, and incur all the legal and liquidation costs, when this farmer may be able to cash flow in just a few months. The system assumes in its evaluation of loans that it will take 2 years to liquidate a farmer. What is a couple months in relation to two years, when a farmer's livelihood and the stability of agriculture is at stake.

I have received many reports that the Farm Credit System is foreclosing on farms and then turning around and giving "sweet heart" deals to non-stockholders of the system. Such deals include: selling the land at a lower price; not requiring the new owner to buy stock in the Farm Credit System; allowing the new buyer make low down payments; and most importantly, offering lower interest rates to these new owners than they do to their own members. In many cases, if the same opportunity had been offered to the original owner, a stockholder in the system, he could have survived.

When I first heard these reports about "sweet heart" deals, I could not believe them. During my hearing in September, I asked Mr. Harling, President of the Farm Credit Banks of Omaha, about this practice and my worst fears were confirmed. When I asked him to justify this policy the reply I received was: "we don't want to leave the impression...that we are giving preferential treatment to the borrowers who are having financial difficulties". Yet they are willing to give preferential treatment to non-stockholders of the system. This twisted philosophy is ruling their actions. These type of policies will bankrupt the system and will cost the U.S. Government billions of dollars unless we put them on hold until more intelligent decisions can be made.

The Farm Credit System will say that these actions are necessary to shore up their assets. The professional managers of the Farm Credit System don't even know where they are at financially. Every projection that has come from the system has been grossly "off the mark". Just 3 days before my hearing in September the Farm Credit Administration admitted that they needed help. This was only 30 days after Governor Wilkinson had denied that there was any need for government assistance.

It is obvious to anyone who has studied the Farm Credit System, that the professional managers of the system want it to be one big nationwide diversified bank. I encourage my colleagues to read the "project 1995" study and speeches given by officials of the system. They would like to first consolidate all the banks and associations in a district into one district-wide bank or association. Then they would like to consolidate all the districts into one nationwide bank. Finally, they would like Congress to write them a "blank check" and allow them to do whatever they want. Many Senators may think that this is just a dream. Let me tell you that this is happening today, right under our noses. The system is using "Gestapo tactics" to blackmail its own membership into voting for mergers and consolidations. These mergers and consolidations take all meaningful control away from the stockholders on the local level.

We know that plans are being made to eliminate all members of the boards of directors, whose loans are not of the highest quality. We know that once these consolidations take place presidents of local banks and associations become answerable to the district presidents and not local board members or stockholders. We also know that the Farm Credit System is threatening to liquidate all the associations and banks which do not vote for the consolidations and mergers the system wants. This is despite the fact that during my hearing, it became clear that the system could not afford to liquidate even one association because it would cause a "chair reaction" that would first destroy the district and then destroy the whole Farm Credit System.

Many people might say, "Why don't these farmers just get our the the system if they don't like it?". Many farmers can't leave because their production credit association's stock has been frozen. When stock is frozen it turns from an asset to a liability. Other commercial lenders look at this as a potential loss instead of a liquid asset. Let me make this perfectly clear, these farmers cannot redeem their stock, which is 10% to 15% of their loan, even if they walked in today and paid off their loan completely. These farmers are forced to wait until the system decides their fate. The system has told these farmers that if they don't vote for the mergers the system wants they will lose their stock, which means instant bankruptcy for many of these farmers. This isn't a choice, this is a threat.

I have been contacted by commercial bank presidents and past and present officials in the system who believe the system is destroying the whole economic fabric of Rural America. These same officials and bank presidents are afraid to speak out in public because the system will retaliate against them. Senators, this is happening today, in America, and we must put a stop to it.

Mr. Chairman, I want to make it very clear that this is a problem not just in my district but across the nation. I admit that things are worse in my district and Senators would take notice. What is happening in my district today will be happening in your district tomorrow. The pattern is clear, the system takes one district at a time, one board of directors at a time, one bank at a time and one group of stockholders at a time. The system is patient in deciding who will be the next victim, but once they decide, they attack. Since the beginning of this year the Farm Credit System has managed to wrestle away all real power from the stockholders in my district. The only action that is left for them to do is to officially vote away their authority next month. Board members and farmers tell me that they don't want to give away all their local control and that they don't believe these consolidations will be significantly more efficient. Why do farmers vote for these consolidations? Because the Farm Credit System tells these farmers that if they don't vote for consolidations, they will be liquidated. To scare these farmers even more, they have started foreclosing on many of their neighbors and friends.

If a Senator is interested in finding out if his district may be next I suggest he look at the financial condition of his district's banks and associations. If your district is in any kind of trouble, you better look out. The St. Paul, Wichita, Louisville, and Columbia districts are prime targets for the system's plans. As a matter of fact, I believe the process has already started in some of these districts.

I am not here to say "the sky is falling". I am here to say that it has already fallen. We, in Congress, have a responsibility to stop it from falling any further and then putting it back up where it belongs. The Farm Credit System's professional managers need to know that Congress is not going to lay down and let them walk over us. They need to know that we believe in a locally controlled system. They need to know that if we are going to get rid of any layer of the system's bureaucracy, it is going to be the top layer not the bottom layer.

I believe that any bail out plan for the system needs to include more local control, more arms length regulatory authority, and a re-establishment of stockholders rights. Any financial assistance has to be geared to help the farmer and not just the system. All these policies will take time to legislate and implement. While we discuss solutions in Congress, we need to know that the system is no longer foreclosing on its farmers and tightening its grip around the throat of the system.

These are times of extreme difficulty. No one in this body has a real reference point to draw from in order to deal with the crisis we are experiencing today. Few, if any, of us were around during the last depression. Our memories are at best clouded and that of youngster. We need to look beyond standard practices. We need to be creative and challenge ourselves to meet this completely new situation. But we can't be creative and make clear headed decisions when our farmers are being bled to death by a system that was created by Congress.

STATEMENT OF HON. JAMES ABDNOR
A U.S. SENATOR FROM SOUTH DAKOTA

Mr. Chairman and distinguished members of the committee. No longer can we assume the luxury of addressing the farm credit problem through the use of inflammatory rhetoric. The problem is real and we don't need further endless documentation of its existence. It is time to talk alternatives and solutions. For the past year my staff, the Joint Economic Committee--of which I am the co-chairman--and I personally, have been visiting with farmers and ranchers as well as representatives of the Farm Credit Administration. We all agree that it is a crisis that must be dealt with immediately. Time must be spent solving the problem rather than trying to allocate blame.

What can be done? First, this past week, I introduced an amendment to the farm bill that requires the Governor of the Federal Reserve System, in consultation with the Secretary of Agriculture and the Governor of the Farm Credit, to study methods to ensure availability of adequate credit for farmers. This study is extremely important due to, first, the general lack of understanding of the system by virtually everyone--all the way from the borrower to the lender--and secondly, because it will be performed as an independent study. As I stated on the floor when I introduced the amendment, "I do not believe that the Agency which has the problem should investigate itself."

But can we wait for the final results of a study? Probably not. For this reason it may be necessary to take immediate measures. Farmers don't want a handout, but they do want an opportunity to survive this period of intense stress in the industry, which was largely not of their making. It may be necessary to make an immediate infusion of funds into the industry, at least until we can better understand the farm credit system and respond to the recommendations of the study I have proposed. If immediate action is necessary, and I believe it is, let's do it and be on with the task of forming a solid credit foundation for the agricultural industry.

I am dismayed with what has happened in the farm credit system. Why wasn't Congress made aware of the problem two years ago? Something is wrong with the system is a must, for without it, the industry could be in jeopardy of losing its primary source of funding. That potential risk is much too costly to even consider.

Thank you for your kind consideration.

STATEMENT OF HON. DONALD E. WILKINSON
GOVERNOR, FARM CREDIT ADMINISTRATION

I. INTRODUCTION

Mr. Chairman, the financial condition of the Farm Credit System is critical. Changes are necessary to ensure that it can continue to fulfill its statutory mission and to minimize the possibility of a recurrence of this situation.

There are three areas in which action is necessary. First, expand FCA's enforcement powers and clearly define its role as an armslength, independent Federal financial regulatory agency. Second, mandate that the System engage in self-help by pooling and managing its resources and distressed credit. And third, determine an appropriate level of public sector support for the System based upon the public policy objectives it serves.

We have come to the realization that a confluence of events and circumstances, many of which are beyond anyone's control, will stretch the financial resources of the System to their limit. Any prospects for near-term improvement or even cessation in the unrelenting economic decline in agriculture have disappeared. The most recent reports confirm further decreases in export markets and massive surplus production in 1985, practically ensuring low commodity prices for several years. We also see continued downward-spiraling of collateral values, particularly land values, and the prospect of substantial distortions in land prices from excess offerings as large groups of distressed farmers attempt to restructure their financial situations.

The challenge we face is to halt the decline and to stabilize the agricultural sector while preserving the essential elements of a farmer-owned cooperative lending network that serves the national interest.

II. HOW DID IT HAPPEN?

A. Where Agriculture is Today

Agriculture is currently undergoing an immense financial adjustment in response to a number of unfavorable -- and unanticipated -- events that have bombarded the industry since the late 1970s. Although the general economy has enjoyed a strong expansion during the past 2 1/2 years, the farm sector has been staggered by a mixture of secular problems that have reemerged after a brief respite in the 1970s and by some striking new problems. Because of these problems, agricultural exports have slumped, asset values have declined, and farm income has stagnated at levels inadequate to service some of the debt incurred by some farmers during the expansion of the 1970s. Thus, farm-business failures have increased dramatically from the low levels of the previous 2 decades. Furthermore, these problems have spilled over into rural communities. Most businesses serving the farm sector, regardless of geographic region, have encountered reduced sales and sagging profits. And as we know, the financial stress problems in agriculture have been particularly evident among rural lending institutions.

B. How Agriculture Got There

Three factors account for much of the financial stress that currently exists in agriculture.

1) The first is the erroneous expectation shared generally by farmers, lenders, and policymakers that the environment of the 1970s would continue well into the future. Certainly, the ebullient events of this decade convinced many people that the traditional problems with excess production capacity, slow demand growth, and stiff export competition were finally resolved. These views were given credibility by many expert forecasts. Scarcity rather than surplus was to be the new norm. The prospect of strong export growth and rising land values encouraged many farmers to expand their operations. Because agriculture is a capital-intensive industry, heavy borrowing was required to accomplish this goal.

   Even today, there are those who do not yet realize that this expectation is a false one. We are not simply in a temporary downturn. American agriculture is undergoing a major structural adjustment.

2) The second factor was the inflation psychology that gripped investors both here and abroad. Farmland, like many other real assets, was viewed as a store of value against inflation and became a speculative investment for some. The expectation that land would continue to appreciate pushed values to levels that were totally unrelated to and inconsistent with its income-generating capacity. While some recognized this as an imprudent business practice, no one could forecast with certainty that inflation would be brought under control, or the timing of it.

While it is easy to criticize these credit decisions today, it should be noted that the tripling farm debt between 1970 and 1980 was in line with most of the indicators used to measure creditworthiness. For example, farm real estate assets also tripled during the decade, increasing from $215 billion in 1970 to $755 billion 10 years later. In addition, net farm income was generally favorable in the 1970s, marked by peaks of $34.4 billion in 1973 and $32.3 billion in 1979. Because of these strong income levels, the returns to equity from income in the farm sector performed well during the decade, averaging about 4.5 percent per year even with the sharp expansion in debt financing compared to 3.4 percent per year during the 1960s. Agriculture started the decade with conservative leverage overall, and it ended the decade nearly as conservative overall. Therefore, the problem of the 1970s was not that farm debt expanded too rapidly; the problem was that too much of the debt fell into too few hands.

3) The third factor was the combination of macroeconomic policies used to achieve inflation control. First was the abrupt change in monetary policy that occurred in 1979 and the deregulation of financial institutions in 1980. The Federal Reserve permitted interest rates to rise as they may to slow the growth in the money supply to wring the inflationary spiral out of the economy. Deregulation added to interest-rate pressures as banks competed more aggressively for a limited supply of funds with new instruments that offered investors higher yields. Second was the simultaneous following of an expansive fiscal policy that necessitated both more stringent and more prolonged monetary restraint to deal with inflation.

The unprecedented increase in interest rates during the 1979-81 period accomplished the intended purpose; the back of inflation was broken more completely and rapidly than many thought possible. The annual rate of increase for the GNP deflator fell from 9.6 percent in 1981 to just under 4 percent in 1984. Although agriculture has benefited significantly from less inflation, it also suffered from major undesirable side effects. The high foreign exchange value of the dollar worsened immediate impacts of demand curtailment, while high real interest rates speeded the disappearance of inflation-induced investment. Expected income growth did not materialize and jeopardized the basis for more highly leveraged borrowers. Sharp declines in commodity prices and asset values have reduced repayment capacity and have eroded the credit quality agricultural loans.

The rest of the story is well known. Between 1981 and 1985, U.S. farm real estate values declined about $151 billion, with over $100 billion of that drop occurring in the past year. This erosion of real estate values greatly reduces the ability of lenders to collateralize loans to cover cash-flow shortages. It also explains, perhaps more than any other factor, who farm borrowers and lenders now face their most serious crisis since the Depression. The problem focuses on the System because, unlike commercial banks, the largest share of its loan volume is in real estate mortgages.

C. The Financial Dilemma Facing Farmers

The dimensions of the financial stress problem of farmers have been widely chronicled by the press and academia over the past year. In addition, the U.S. Department of Agriculture (USDA) has used census information and results from cost-and-returns surveys to develop an excellent profile of the financial stress problem We believe that this information accurately portrays the seriousness of the situation.

USDA reported that about one-half of the Nation's farm operators had negative cash-flows in 1984. Approximately $50 billion of farm debt is held by operators with both a negative cash-flow and a debt-to-asset ratio over 40 percent, which may be a good indication of the magnitude of the financial problem. Given the events of 1985 regarding bumper crops, falling exports, and low commodity prices, the figure can only be growing. While some analysts suggest the USDA measures of cash-flow are overly strict, conditions have deteriorated during 1985. Further, based on an examination of production credit association (PCA) data, we believe that most operators with debt-to-asset ratios above 25 percent are probably experiencing stress, especially those from the Midwest and Great Plains.

According to USDA, of the $50 billion in troubled debt, about $13 billion is held by operators with debt-to-asset ratios between 70 and 100 percent, while another $11 billion is held by those who are insolvent -- their ratios are above 100 percent. Therefore, $24 billion of the debt was probably at or approaching nonaccrual status on January 1, 1985. Farm Credit Administration staff has made projections of the likely increases in troubled debt under a pessimistic outlook for commodity prices and asset values. Based on our assumptions, the amount of troubled debt in the total agricultural sector could increase to almost $35 billion by the end of 1988 ($14 billion in the 70-100 percent category and $20.5 billion in the insolvent category).

The effect of this situation on the System in general and the Federal land banks (FLBs) in particular is profound. The USDA figures showed that about $4 billion of FLB debt is held by operators with debt-to-asset ratios between 70 and 100 percent and negative cash-flows, and $3.5 billion is owed by insolvent operators.

If land values should fall another 20 percent from January 1985 levels within the next 2-3 years, FCA estimates that a cumulative total of $13 billion of System loans may become nonaccrual by the end of 1987. Given past collateral-recovery rates and future economic forecasts as a basis for loss projection, the restructuring and liquidation of $13 billion in loans could result in chargeoffs of $6 billion. Potential losses of this magnitude threaten the financial viability of the System. This is why contingency plans for financial assistance must be put in place at this time. (See appendix A for 37 Bank financial statements as of September 30.)

The farm-debt problem reflects the transition that agriculture is undertaking as it adjusts to the realities of less inflation, deregulation in financial markets, and the full integration into changing world food and fiber markets. Agriculture and the institutions that serve it can respond to broad changes in economic conditions given enough time. It is unlikely that agriculture can avoid making these adjustments, given the restraints on the Federal budget. So public policies are needed to buy time to allow an orderly adjustment to take place. In the absence of appropriate policy, the transition costs to the farm sector and rural communities could be immense. One of the many casualties would appear to be the System.

D. Experience of Others

Financial stress in agriculture is affecting the commercial banking sector as well. Their situation compares to the PCAs, which have also experienced significant losses. But the potential problem is less in total than the FLB exposure to dropping land values. Close to 400 agricultural banks are on the Federal Deposit Insurance Corporation's problem bank list. In the first half of the year, commercial banks charged off $520 million in farm production loans, up 85 percent from the first half of 1984. On June 30, total nonperforming loans at agricultural banks were 7.3 percent of the total portfolio, compared to 5.7 percent a year earlier. Nonaccrual loans were 5.2 percent of all loans at these banks, up from 3.8 percent last year. These difficulties result in a growing number of bank failures. Of the 82 bank failures so far this year, 49 have been agricultural banks. This figure already exceeds the total number of failures for all of last year when 78 banks failed, of which 32 were agricultural. From this information, it is clear that financial stress has permeated all lending institutions, and those with a large proportion of their portfolios in agricultural loans are no doubt retrenching.

As of January 1985, the situation facing the System appeared to be manageable within its own resources. Indeed, results of the USDA's 1984 Farm Costs and Returns Survey as enhanced by the Federal Reserve, showed that commercial bank loans were in slightly weaker hands than borrowings from the System, while as expected, the FmHA had the highest portion of loans to vulnerable farmers (see appendix B). What distinguishes the financial condition of the System today from the commercial banking sector is the rapid decline in land values and the System's domination of the farm real estate mortgage market. It now appears that 1985 alone will see land prices down nationwide as much as 10 percent; this on top of a 19-percent decline since 1981.

E. Looking Ahead in the System

Based upon FCA's analysis of the current and projected financial condition of the System, parts of it are already nonviable.

The System's competitive position may be lost well before the damage is reflected on its balance sheet. This is true because any amount of capital is adequate only so long as investors in System securities think it is. Adverse trends in financial ratios are likely to result from continued deterioration in the agricultural economy, additional loan losses, and loss of the System's ability to attract and retain financially sound borrowers.

These trends threaten the System's ability to continue to sell securities well before capital is lost. The System would likely be unable to fund itself and yet retain substantial financial resources if the financial markets lose confidence in the System's ability to manage its financial problems and become unwilling to refinance its maturing debt obligations.

The effects of a loss of market confidence would be devastating. The financial markets will be impaired with major additional cost born by other agency market entities and investors holding FCS and other agency securities.

The System is faced with a dilemma in trying to generate earnings and reserves for losses in order to halt these financial trends and retain funding capacity. The necessity is to charge higher interest rates to generate revenues necessary to meet the cost of carrying nonperforming loans and writing off losses. But higher rates exacerbate borrower flight as quality loans are refinanced at lower commercial credit rates. In addition, borrowers may leave because of the risk of loss of their equity investment in association stock, should the association fail. Those who cannot find alternatives, especially those with the weakest financial position, are further stressed by paying higher interest rates.

Compounding the System's problems is the fragmentation of its financial structure vis-a-vis its centralized fund-raising activity. The 37 System banks are jointly and severally liable to repay their consolidated notes and bonds. This access to the Nation's money markets is ensured in part through the combined financial strength and repayment record of the 37 banks. Yet, managing the capital and retained earnings of all 37 banks to maintain investor confidence and meet maturing obligations has been difficult. At best, negotiating necessary loss-sharing agreements has been time consuming and costly. And the threat always exists that one or more institutions may balk at approving them.

III. SOLVING THE PROBLEM

As I mentioned at the outset of my testimony, there are three actions that Congress must take to solve the problem. First, expand the FCA's enforcement powers and clearly define its role as an arms-length, independent Federal financial institution regulatory agency. Second, mandate that the System engage in self-help by pooling and managing its resources and distressed assets. And third, determine and appropriate level of public sector support for the System based upon the public policy objectives it serves.

A. The Role of FCA as Arms-Length Regulator

Once changes are made to FCA's statutory role as a Federal financial regulatory agency, then we can proceed to consider Federal assistance to the System with assurance that the public interest will be protected. Those changes are (1) improve the checks and balances on associations and banks; (2) enact enforcement authorities for FCA to correct unsafe and unsound banking practices; and (3) increase market discipline through accountability of management to stockholders.

Last week, we submitted legislation to the respective chairmen of the House and Senate Agriculture Committees that would extensively amend the Farm Credit Act (Act) of 1971, as amended, to reorder the FCA and equip it to meet the challenge of protecting the public interest. We take this public interest to include the protection of investors and stockholders in system institutions, as well as borrowers both now and in the future.

In making the following recommendations, we recognize the need to enhance our independence as a Federal financial regulatory agency. This recognition is based upon three assumptions. First, the public interest and that of the System do not always coincide in the short term. Insofar as the FCA is concerned, the public interest is paramount. Second, the FCA cannot guarantee the ultimate success or failure of the individual institutions of the System. This accountability lies with those who own the System through their elected boards of directors. And third, providing leadership and direction is fundamentally incompatible with the responsibility of regulating, examining, and supervising the System. The System must either provide its own leadership focus or operate without it.

1. Improve Checks and Balances on Banks and Associations.

FCA proposes to eliminate the statutory provisions authorizing and directing FCA to delegate its duties and powers to institutions of the System. This would require FCA to reassume direct responsibility for examining and supervising all System institutions. We believe this is the proper role for a Federal financial regulator. Recent experience raises serious questions regarding the reliability of bank credit reviews in stressful conditions.

The remaining authority of FCA will be governmental authority that should not be delegated to private institutions. This change is consistent with the overall purpose of the legislation we propose, which is to affirm and clarify the role of FCA as a financial institution regulatory agency and the role of System institutions as privately owned lenders.

The banks should still retain present statutory controls over the actions of the associations that are consistent with a principle/agency relationship with respect to Federal land bank associations (FLBAs), and a debtor/creditor and sole-source relationship with respect to PCAs. Of course, System institutions would be expected to continue to conduct their own internal audits.

2. Intermediate Enforcement Authorities

The present enforcement tools available to FCA are inadequate to ensure the safety and soundness of the financial institutions it supervises, regulates, and examines. Supervision by persuasion has proven ineffective.

Presently, FCA's enforcement authorities are designed to attack problems after the fact -- "upon default" or after an association has "failed to meet its obligations." FCA's approval authorities permit it to attempt to forestall problems at the outset, but at the price of injecting itself into the management decision making process of System institutions. There currently is no intermediate enforcement authority to correct situations as they develop.

We recommend the enactment of legislation establishing intermediate enforcement authorities for the FCA comparable to those possessed by other Federal financial regulatory agencies. These authorities will permit FCA to stop or alter a course of action that the regulator believes is unsafe, unsound, threatens the strength and stability of a financial institution, or violates the law, rules, or regulations.

Specifically, we request that FCA be granted authority to issue cease-and-desist orders and temporary cease-and-desist orders, remove or suspend officers, directors, or other persons participating in the affairs of institutions, and impose civil money penalties. These authorities would be exercised by FCA pursuant to statutory provisions requiring that notice and an opportunity for a hearing be provided to affected parties. If an order is issued, the affected party could also exercise rights to judicial review.

In February of this year, we transmitted to the respective chairmen of the House and Senate Agriculture Committees FCA's proposed legislation regarding these enforcement authorities. Since that time, the proposal has been addressed by interested parties at seven separate hearings before the House and Senate.

Based upon testimony presented at those hearings and after extensive negotiations, we recommend certain modifications to what we proposed last February. There are a number of substantive changes between the enforcement powers provisions contained in the legislation we have just submitted and provisions previously introduced in the Congress (Section 8 of S. 1598, Section 8 of H.R. 2609, and S. 466).

- Previous bills authorize enforcement proceedings against officers and directors who had "negligently" disregarded the safety and soundness of the institution. Today's bill would establish a higher standard for such actions by requiring a demonstration of "gross negligence."
- Previous bills would not require that hearings relating to enforcement matters be held in private. Today's bill

would provide that such hearings would be private, except when the FCA determines that a public hearing is necessary to protect the public interest.

- Previous bills provide two bases for the imposition of civil money penalties: a) the violation of a final cease-and-desist order; or b) the violation of any provision of the Act of any FCA Regulation. Today's bill would limit the authority of FCA to impose civil money penalties to situations involving the violation of cease-and-desist orders.
- Today's bill would eliminate a provision contained in previous bills that would authorize FCA to revoke the charter of an institution if its directors had knowingly violated or permitted the violation of any provision of the Act.
- Previous bills authorize the imposition of temporary cease-and-desist orders when the activity would cause a substantial dissipation of assets or would be likely to seriously weaken the financial condition of the institution. Today's bill establishes a lower threshold for action by deleting the words "substantial" and "seriously."
- Today's bill contains a new provision that authorizes the Governor to define what constitutes an unsafe or unsound practice on an individual basis as that term is used in each enforcement proceeding.
- Today's bill contains a new provision authorizing the Governor to appoint a person to replace an officer who has been suspended or removed until judicial review of the removal is completed or until the board of the institution appoints a successor who has been approved by the Governor.

3. Increase Market Discipline and Accountability

Shareholders and investors have a right to accurate and timely information regarding the performance and condition of System institutions. Through appropriate disclosure and clear lines of accountability, the market and shareholders can effectively discipline System institutions.

FCA has proposed regulations that would require banks and associations of the System to issue annual reports and information statements to shareholders before annual meetings and to file reports of condition and performance with the FCA in accordance with prescribed accounting formats. In addition, we have designated in those proposed regulations reports to shareholders and specific portions of the reports of condition and performance as public information.

We firmly believe that shareholders of System institutions should receive accurate and timely information before electing directors so as to encourage more shareholder participation in the affairs of their institutions and to hold directors and management accountable for their actions. System banks and associations now report to their shareholders annually, but there are no standards for the form, content, and distribution of such reports. We have proposed that each System bank and association be required to issue an annual report to its shareholders within 90 days of the end of the fiscal year and to transmit a statement containing information specified in the regulation to shareholders at least 15 days before annual meetings at which directors are to be elected. The reports would be filed with FCA and available for public inspection.

The annual reports of System banks and PCAs would include financial statements audited by certified public accountants, including a copy of the accountant's opinion.

A copy of the proposed regulations and a complete description appears in the August 27, 1985, Federal Register beginning at page 34711.

Further obscuring accountability within the System are a number of statutory prior approval authorities that are vested in FCA. Such authorities are fitting of a program administrator. But for a financial institution regulator, they have the effect of injecting the regulator into the day-to-day management decisions, which are more properly the prerogatives of institution management.

We therefore propose a number of amendments to delete certain specified functions that are not consistent with FCA's role as a financial institution regulatory agency and that are more appropriately handled by the individual System institutions. The amendments also specify that when FCA is required by statute to approve transactions or activities, such approvals can be given through regulations. Such regulations would grant approval on the basis of the institution's satisfaction of or compliance with standards and criteria contained in the regulations.

Specifically, we propose to eliminate the authority for FCA to approve 1) the salary scale for employees of System institutions and the compensation of the chief executive officers of such institutions; 2) special assignment days in excess of 30 for district directors; 3) PCA lending standards, which are prescribed by the district Federal intermediate credit bank (FICB); 4) individual issues of system securities and execution of consolidated and Systemwide obligations (although FCA should retain authority to approve classes of securities and regulate their issuance).

We propose strengthening FCA's authority to regulate the preparation by System institutions and dissemination to stockholders and investors of information on the financial condition and operations of System institutions.

In view of this new authority, we propose to eliminate a number of specific powers, including the power to (1) coordinate the activities of banks in making studies of lending standards, the approval of standards, and other similar activities; (2) prescribe loan-security requirements and the loans that can only be made through prior approval; (3) coordinate, assist, and provide services associated with the effective management of System institutions; (4) prepare and disseminate information to the general public regarding the System and the merits of its securities; and (5) execute systemwide or consolidated securities on behalf of the System institutions.

B. How The System Can Help Itself to Solve Its Problems

Losses in the System are growing at a rapid rate and threaten to overwhelm its substantial reserves and its ability to deal with problems internally.

While the System faces a potential liquidity crisis, it still retains considerable financial resources.

Because of the turmoil in the agricultural economy, many System institutions are spending the majority of their time servicing their distressed loan portfolio, rather than meeting the needs of creditworthy farmers. Given their traditional orientation toward loanmaking, rather than collecting and restructuring, System banks and associations are often ill-equipped to manage effectively a highly distressed loan portfolio, making a bad situation worse.

We propose, therefore, that the Farm Credit System Capital Corporation (FCSCC) be granted statutory authorities to implement System self-help efforts. Capitalized by System funds and staffed by highly competent workout specialists, the FCSCC's job will be to work out troubled System loans in a businesslike manner. This approach will allow the attention of the banks and associations to return to the business of making sound credit available to American agriculture.

There are four key aspects to this approach: (1) it mandates that the System pool its capital base; (2) it permits the System to pool its distressed loan assets; (3) it facilitates the restructuring and disposal of distressed assets; and (4) it permits effective management of System capital and Federal assistance. These authorities would be carried out under the supervision and control of FCA through the regulating and examining process. Within these parameters, the System can manage its own problems but FCA could have the authority to intervene to protect the public interest.

The benefits of this approach will be immediate and direct to both System institutions and their member-borrowers:

- o If debt markets can be reassured that the risk of investing in System securities is small, the interest expense to System borrowers can be contained and possible reduced after distressed loans are transferred;
- o A more stable System will be under less pressure to liquidate assets to generate cash, improving the market climate in many rural areas, improving confidence, and contributing to the stabilization of farm-asset values;
- o Appropriate and expert handling of distressed System assets will optimize return and minimize losses within the distressed asset portfolio, acceleration recovery of the System and minimizing cost.

The financial markets are associating greater risk with System securities than ever before, and this is reflected in the interest-rate spreads over Treasury securities that these markets demand. Without immediate action to assist the

System's efforts to deal with its problems, these higher borrowing costs will have to be passed on to its borrowers, further increasing pressure on farmers at a time when many are unable to bear the burden they already have.

Also, there remains the danger that market risk perceptions will worsen further and raise the specter of default by the System.

The concept of centralizing distressed assets in a specialized organization is not unique.

The System's experience in capital assistance and asset restructuring supports the view that centralizing distressed assets and their workout will help stabilize the rural economy and improve the ability of the System institutions to return to the business of making sound credit available.

The emphasis on the size of expected System losses tends to obscure the fact that the System retains a substantial cash-flow generating capability. Not only is the System a valuable national asset, one that should not be discarded, but if provided the resources to survive this stressful period, the System will have the opportunity to return to the purposes for which it was designed.

Self-help is an essential step to preserving the System's viability as an agricultural lender and intermediator of funds from the savings-surplus sectors of the economy to the savings-deficit farm sector. System default would have a devastating, costly, and long-lasting effect on the financial infrastructure of rural America.

Experience shows that the most effective way to address the growing crisis is to pool System resources and distressed assets in a single institution. This can be implemented by the System now, with some modification to the Farm Credit Act.

Timely self-help is essential to reassure nervous debt markets and System borrowers, contain borrower interest costs, and stabilize farm-asset values.

C. Alternatives for Public Sector Support

The decision of how much Federal financial assistance to provide the Farm Credit System is one that can only be made by Congress and the Administration based upon the public policy objectives it wishes to serve. FCA's responsibility is to recommend what it believes to be the most prudent course of action to preserve the essential elements of the Farm Credit System as a stable and reliable source of competitively priced credit to creditworthy farmers, ranchers, and their cooperatives.

We therefore will outline for your consideration three alternatives for public sector support. We assume in each alternative that Congress will act to grant FCA enforcement authorities and clarify its role as an arms-length regulator, and that Congress will mandate that the System make the maximum use of its own substantial resources by augmenting the role and authorities of the Farm Credit System Capital Corporation.

ALTERNATIVE ONE: NO FINANCIAL ASSISTANCE

This approach at best will increase System funding costs as investors demand an even higher risk premium on its securities, and at worst will cause the liquidation of the Farm Credit System.

From a borrower's standpoint, it increases the uncertainty of credit availability, and raises the prospect of loss of borrower investment (B stock), increases upward pressures on interest rates, and downward pressures on land values. It also places tremendous pressure on System institutions to liquidate and dispose of its assets to generate cash to cover maturing obligations.

If no form of Federal financial assistance is provided, the impact on the financial community will be significant as well. Other agency market borrowers will likely experience an increase in funding costs as uncertainty is introduced in agency markets. Holders of System securities will experience a marked loss in value of their portfolios.

Rural communities will feel the impact as more agricultural related businesses are closed. There will be increased stress on commercial banks as asset values are destabilized.

The government will feel the impact in terms of lost revenue base and increased pressures on the Farmers Home Administration and Commodity Credit Corporation to meet farmers' credit needs.

The benefits of this alternative is that it will keep the pressure on System institutions to establish efficiency of operation, make maximum use of its resources, and operate in accordance with a strict business plan.

ALTERNATIVE TWO: BACKUP LINE OF CREDIT

This alternative is to provide the Farm Credit System with a backup line of credit from the Federal government that can be rawn up to $5 billion through a modified Governor's Revolving Fund once the System's resources have been adequately committed. This approach will negate many of the undesirable effects of alternative one. We believe this kind of backstop would provide the necessary reassurance to the financial markets to ensure the continued availability of funds. This approach also keeps a desirable level of pressure on the System to establish greater efficiencies and maximize the use of its own resources in dealing with problems without pushing individual institutions into a crisis-management position. This alternative should also stabilize interest rates on a System basis and reduce them for some institutions; alleviate borrower concerns over the loss of credit sources; and encourage a more orderly process for managing distressed situations. Under this alternative, no taxpayer funds would be committed until the clear need to do so was evident.

ALTERNATIVE THREE: UPFRONT FINANCIAL ASSISTANCE

This alternative provides direct, upfront, financial assistance combined with a contingent line of credit. However, FCA is concerned with the immediate budgetary impact this approach would have. We are also concerned that it would reduce the System's incentive to increase operating efficiency.

In conclusion, we recommend the following congressional action:

1) Grant FCA expanded intermediate enforcement authority and clarify its role as the arms-length regulator of the Farm Credit System;

2) Mandate that the System use its own resources by establishing statutory authority for the Farm Credit System Capital Corporation; and

3) Establish an adequate backup line of credit to be drawn upon as the need is demonstrated.

[Appendix A]

TESTIMONY OF HON. DONALD E. WILKINSON, GOVERNOR FARM CREDIT ADMINISTRATION

Financial Condition and Performance, Farm Credit System, Quarter Ending September 30, 1985

Material presented herein was compiled from reports of financial condition and performance filed with FCA by Farm Credit banks for the quarter ending September 30, 1985. The information presented is as reported by the banks and reflects all revisions to initial reports received through October 25, 1985. Because further revisions are expected, the information is considered preliminary and subject to change.

FCA has neither approved nor disapproved the September 30 reports of financial condition and performance filed by FCS banks with respect to conformity to applicable accounting and reporting standards.

Appendix A does not include information on the financial condition and performance of Production Credit Associations. PCA financial reports for the period ending September 30, 1985 are due to be filed with FCA on October 31, 1985. FLBAs report to FCA on a semiannual rather than a quarterly basis.

FCA expects to publish its Report of Financial Condition and Performance of the Farm Credit System for the third quarter of 1985 on or about December 6, 1985.

Credit Conditions as of September 30, 1985

1. Several recent exonomic statistics suggest that the economy is entering a period of some acceleration in growth. The 3.3-percent growth rate in real GNP for the third quarter represents an improvement over the 1.1-percent average of the first half. However, the underlying fundamentals of the current economy do not appear to support strong growth.
2. The trade deficit has continued to rise. While the rise in July was less that in June, most of the difference was a temporary decline in imports. Over the rest of this

year, trade deficits are likely to continue at or above their current level.

3. Firming of the economy has been reflected in stabilizing interest rates. Additional economic strength is likely to put some upward pressure on rates.
4. The dollar has been on a downward trend since early in the year, due primarily to lower U.S. growth and declining interest rates. The dollar might be expected to firm at the prospects of a somewhat stronger economy and higher rates. In concert with Germany, Japan, Britain, and France, the U.S. has launched a coordinated program to force the dollar down.
5. Record large U.S. feed grain production materialized during the third quarter, portending a 1985/86 carryout second only to that of 1982/83, double that of 1984/85, and triple the 1983/84 level. While other domestic crops did not have record harvest, production far exceeds anticipated use, meaning record buildups of stocks and continued downward pressure on prices.
6. Red meat output continued to exceed expected levels, keeping a lid on prices and causing losses for feeders. Financial stress has meant continued liquidations, and heavy slaughter weights in anticipation of near-term price recovery has delayed such improvement.
7. U.S. agricultural export prospects continued to weaken during the third quarter. Just ended fiscal 1985 saw the dollar value slip $6 billion to $32 billion and the tonnage drop 15 million to 129 million metric tons. Further significant drops in volume and value are likely in fiscal 1986 even is the dollar continues to weaken.
8. Farm income prospects among crop producers vary greatly depending upon enrollment in the government programs. Somewhat under half the grain producers having 70-75 percent of the base program acreage are enrolled and can expect maximum deficiency payments, while those not in the program will do well if they can receive the loan rate as the market price.
9. Federal Reserve Bank surveys covering the second quarter found farm land values declining an average of 4.6 percent in the Chicago district and near 7 percent for ranchland and nonirrigated land in the Kansas City district, but values were stable to slightly mixed in the Dallas district.
10. CCC lending on the 1985 crops is expected to be record large due to depressed market prices and fairly high proportions of the program acreages enrolled, and a relatively favorable interest rate.
11. Farmers Home Administration - FmHA completed fiscal 1985 with a record level of loan obligations coupled with an inordinately high rate of debt-servicing activity.
    a) Direct lending in the operating loan (OL) program amounted to a record $3.6 billion, far exceeding the original budget of $1.9 billion.
    b) FmHA's debt set-aside program, which allows for the deferral of up to 25 percent of FmHA debt for 5 years, provided

assistance to 15,794 FmHA borrowers during fiscal 1985; another 29,296 borrowers had loans that were rescheduled or reamortized. Of those applying for assistance, 10,440 were considered to have adequate cash-flow without any servicing action, 21,539 were projected to have inadequate cash-flow even if they were granted all available servicing actions, and another 4,662 were rejected on the basis of decisions made by county committees.

c) FmHA received only 656 applications for guaranteed loans under their Debt Adjustment Program (DAP). Most of the guaranteed loan activity occurred within FmHA's regular guaranteed loan program, as $1.1 billion in regular guaranteed operating loans was obligated during fiscal 1985, compared to $55 million in DAP guaranteed loans.

d) As of September 1, 1985, nearly 82,500 FmHA farmer borrowers were delinquent in their scheduled payments, equal to 29.8 percent of active farmer program borrowers. The delinquency rate was slightly lower than a year earlier when 30.6 percent of farmer borrowers were delinquent.

e) For the first 11 months of fiscal 1985 (October 1984 through August 1985), 4,391 FmHA borrowers discontinued farming operations due to financial difficulties, representing 1.5 percent of all active borrowers. Over the same period last fiscal year, 6,262 borrowers were discontinued. The number declined primarily because of a considerable reduction in the number of foreclosures.

12. Commercial Banks - Commercial bank farm nonreal estate loans outstanding at the end of the second quarter were seasonally higher than at the end of the first quarter. However, for the second consecutive quarter, outstanding loans were lower than a year earlier indicating that banks are continuing a more conservative farm lending pattern. Insured commercial banks held $40.1 billion in outstanding farm nonreal estate loans on June 30, 1985, up $1.8 billion, or 4.6 percent, from March 31, but down $1.2 billion, or 3.0 percent, from a year earlier.

13. Contributing to this year-over-year decline is a trend of reduced farmer demand for operating loans, coupled with a borrower shift, both voluntarily and involuntarily, from commercial lenders to government sources of funds (particularly FmHA). The financial performance of agricultural commercial banks continued to weaken during the second quarter, causing banks to be more cautious in their farm lending practices.

a) NET CHARGEOFFS of farm production loans at all commercial banks totaled $520 million in the first half of 1985, equal to 1.3 percent of all such loans outstanding, and up by 80 percent over chargeoffs in the first half of 1984. Historically, the fourth quarter is the most active period for bank chargeoffs, so total chargeoffs for the year will easily exceed $1 billion, compared to $900 million in 1984.

b) LOAN DELINQUENCY RATES at agricultural banks continue to rise, indicating that future chargeoff rates are likely to remain high. At the end of the second quarter, total nonperforming loans at agricultural banks were 7.3 percent of the total portfolio, compared to 5.7 percent a year earlier. Nonaccrual loans, which is the most severely delinquent category of nonperforming loans, were 5.2 percent of all loans at these banks, up from 3.8 percent last year.

c) NET EARNINGS at agricultural banks have been severely hampered by rapidly rising loan losses and higher levels of nonperforming loans. Because of this deteriorating financial performance, 12 percent of agricultural banks reported a net loss for 1984, compared with an average of only 1 percent during the 1970s. Also, in 1984, 17 percent of all agricultural banks made loan loss provisions that exceeded 2.5 percent of yearend loans outstanding.

d) The number of agricultural banks on the FDIC problem bank list continues to rise. Although agricultural banks comprise 28 percent of all commercial banks, ag banks account for 37 percent of all problem banks. Of the 975 problem commercial banks, 363 have more than 25 percent of their loan portfolios outstanding to agriculture.

e) For a growing proportion of agricultural banks, higher levels of nonperforming loans have resulted in the failure of these institutions. As of September 24, 1985, 82 commercial banks had failed, of which 49 were classified as agricultural banks representing 60 percent of the total. In all of 1984, 78 banks failed and 32, or 41 percent, were agricultural banks.

14. FARM CREDIT SYSTEM

Large provisions for loan losses, reflecting FCS exposure to deteriorating farm loan and economic conditions, dominated third quarter financial results reported by Farm Credit banks. On a combined basis, the 37 banks reported provisions for loan losses of $538.9 million which resulted in net operating losses of $592.5 million for the third quarter. Although the combined net worth of the 37 banks remained substantial at $8.543 billion on September 30, it declined $651 million during the quarter. Total net worth declined to 10.6 percent of assets from 11.2 percent on June 30. Problems with the FLB mortgage loan portfolio accounted for the bulk of the increase in the provisions for loan losses. Third quarter financial reports for the PCAs are expected to reflect continuing problems when they become available.

Provisions for loan losses are necessary to ensure adequate allowances for loan losses. Adequate allowances for loan losses reflect risk inherent in loan portfolios and represent their effective devaluation to conform with prevailing conditions.

Provisions for loan losses totaling $509.3 million, $24.4 million and $5.2 million were reported by the FLBs, FICBs, and BCs respectively for the quarter ending September 30. These provisions brought the combined allowances for loan losses to $915.6 million for the FLBs, $51 million for the FICBs, and $122.4 million for the BCs after deduction of current loan chargeoffs. Chargeoffs reported by the FLBs for the third quarter totaled $140.3 million, compared with $1.3 million for the FICBs and $11.1 million for the BCs.

Because provisions for loan losses are charged against current income, they resulted in significant operating losses of the FLBs and FICBs on a combined basis. As a group, the 37 Farm Credit banks reported net losses totaling $592.5 million for the quarter ending September 30. Operating losses of $560.1 million and $39.5 million were reported by the FLBs and FICBs, respectively, while the BCs reported net income of $7.1 million. Third quarter operating losses translated into annualized returns on equity of -39.4 percent for the FLBs and -7.9 percent for the FICBs. The third quarter net income of the BCs represented a positive return on equity of 2.4 percent.

Nonperforming loans reported by the Farm Credit banks continued to increase and totaled $10.633 billion on September 30 compared with $9.821 billion on June 30. The portion of total nonperforming loans comprised of nonaccrual loans increased dramatically during the period, rising from $2.013 billion on June 30 to $3.533 billion on September 30. The bulk of the increase in nonaccrual loans was reported by the FLBs with nonaccruals rising from $1.854 billion to $3.297 billion of the quarter.

Operating losses resulted in declines in the combined earned net worth of the FLBs and FICBs. FLB earned net worth fell from $3.256 billion on June 30 to $2.689 billion on September 30 on a combined basis. FICB earned net worth declined from $599.9 million to $563 million on the quarter. Declining loan volume reduced FLB capital stock from $2.773 billion to $2.671 billion. Total FLB net worth reported by the FLBs declined from $6.029 billion to $5.360 billion. Total net worth reported by the FICBs declined from $2.016 billion to $1.976 billion during the quarter. Total net worth reported by the BCs declined from $1.219 billion to $1.208 billion and was due primarily to a modest decline in capital stock.

a. FEDERAL LAND BANKS.

Assets of the twelve FLBs declined 1.72 percent during the third quarter of 1985. FLBs reported assets totalling $53.280 billion at Sept. 30, 1985, down $930.7 million on the quarter. The decline centered in loans outstanding, which fell $1.802 billion. Declining loan volume was offset partially by increases in accrued interest receivable, investments in securities and acquired property.

The FLBs posted a decline in total net worth for the quarter as both earned net worth and capital stock fell. Earned net worth declined $567.2 million, 17.4 percent, to $2.689 billion. Capital stock fell $101.7 million, 3.7 percent, to end the period at $2.671 billion. Liabilities declined by $262 million, 0.5 percent, ending the quarter at $47.920 billion.

On a combined basis, the FLBs reported net operating losses of $560.1 million after provisions for losses totalling $509.8 million. The losses resulted in a combined return on assets of -4.17 percent and a return on equity of -39.4 percent. Collectively, the FLBs operated with a net interest margin of 0.75 percent for the quarter.

At Sept. 30, the debt-to-capital ratio of the FLBs was 8:94:1 on a combined basis. Total net worth comprises 10 percent of total assets.

FLB nonperforming loans comprised 12.4 percent of loans outstanding at Sept. 30, 1985. Nonperforming loans held by the FLBs totalled $6.098 billion of which $3.297 billion was nonaccrual. The FLBs reported chargeoffs on loans totalling $140.3 million during the third quarter. The net impact kof chargeoffs and provisions for losses from income left the FLBs with $915.6 million in allowance for loan losses at Sept. 30.

b. FEDERAL INTERMEDIATE CREDIT BANKS.

Total assets of the twelve FICBs declined $128.8 million, 0.7 percent, to $18.032 billion during the third quarter of 1985. Total loans outstanding went down $469.3 million, 2.9 percent, to $15.733 billion. Loans to PCAs declined 410.5 million, 2.7 percent, to $14.878 billion. Loans to OFIs declined from $725.9 million to $699.0 million.

Aggregate FICB liabilities declined by $88.1 million during the third quarter, falling 0.5 percent to $16.057 billion. Capital stock reported by the FICBs declined $3.9 million, 0.3 percent, to $1.413 billion. Earned net worth declined $36.9 million, 6.2 percent, to $563.0 million. Total net worth declined $40.7 million, 2.0 percent, to end the quarter at $1.976 billion.

The FICBs reported net operating losses of 39.5 million for the third quarter after making provisions for loan losses of $24.4 million. The net loss for the quarter represents an annualized return on assets of -0.87 percent and a return on equity of -7.89 percent. Collectively, the FICBs operated with a net interest margin of 2.03 percent during the third quarter.

As of Sept. 30, 1985, the debt-to-capital ratio of the FICBs stood at 8.13::1 on a combined basis while total not worth comprised 11 percent of assets.

Nonperforming loans comprised 25.3 percent of FICB loans outstanding on Sept. 30. Some $3.983 billion of the $15.733 in FICB loan volume was nonperforming of which $104.7 million was in nonaccrual status. The FICBs reported loan losses totaling $1.2 million during the quarter leaving the combined allowance for loan losses at $51.0 million on Sept. 30, 1985.

c. BANKS FOR COOPERATIVES.

Assets of the thirteen Banks for Cooperatives declined $634.2 million, 6.3 percent, during the third quarter of 1985, to $9.435 billion. Loans outstanding fell $592.1 million, 7.1 percent, to $7.751 billion.

Aggregate BC liabilities declined 7.0 percent on the quarter, to $8.228 billion. Total BC net worth fell 1.0 percent during the quarter, to $1.208 billion from $1.219 billion. Capital stock declined 1.3 percent to $832.4 million. Earned net worth declined slightly from $375.9 million to $375.1 million.

The BCs reported net income for the quarter of $7.1 million after making provisions for possible loan losses totaling $5.2 million. Net income translated to an annualized return on assets of 0.29 percent and a return on equity of 2.35 percent.

Collectively, the thirteen BCs operated with a net interest margin of 1.58 percent on the quarter.

As of Sept. 30, 1985, the debt-to-capital ratio of the BCs was 6.81:1 on a combined basis. Total net worth represented 13 percent of assets.

Nonperforming loans accounted for 7.1 percent of BC loans outstanding at Sept. 30, 1985 with $552.1 million in nonperforming status and $7.751 billion in total loans. Nonaccrual loans accounted for $130.5 million of total nonperforming loans. Collectively, the BCs reported loan losses totaling $11.1 million for the quarter and ended the period with allowances for loan losses totaling 122.4 million.

Summary of Condition and Income
Components of the Farm Credit System
at and for the Quarter Ending September 30, 1985

1.	Summary of Condition September 30, 1985				
	13 BCs	12 FICBs	12 FLBs	FLBAs(1)	PCAs(2)
			– – millions of dollars – –		
Loans – total principal	7,751.1	15,733.2	49,254.9		
Performing	7,199.0	11,749.6	43,156.5		
Restructured	14.4	612.5	10.3		
Other restructured & reduced rates	47.6	0	17.1		
Other high risk	359.6	3,266.4	2,773.7		
Nonaccrual	130.5	104.7	3,297.3		
Less: Allowance for losses	122.4	51.0	915.6		
Net loans	7,628.7	15,682.2	48,339.3		
Cash & investments in securities	1,519.9	1,733.0	2,041.4		
Net acquired property	6.3	13.2	674.7		
Other assets net of adjustments	280.4	603.9	2,224.6		
Total assets	9,435.3	18,032.3	53,280.0		
Total liabilities	8,227.8	16,056.6	47,920.3		
Capital stock & participation certificates	832.4	1,412.6	2,671.1		
Earned net worth	375.1	563.0	2,688.5		
Total net worth	1,207.5	1,975.7	5,359.6		

(1) FLBAs report to FCA on a semiannual basis rather than a quarterly basis. The next FLBA reports to FCA will be at and for the 6 months ending December 31, 1985.

(2) Quarterly PCA reports to FCA for the period ending September 30, 1985, are due in the agency on October 31, 1985.

Components may not add to exact totals due to rounding.

2.

Summary of Income and Expenses
Quater Ending September 30, 1985

	13 BCs	12 FICBs	12 FLBs	FLBAs(1)	PCAs(2)
	- - millions of dollars - -				
Total Interest Income	232.4	452.4	1,435.9		
Less: Total Interest Expense	194.4	364.1	1,339.1		
Net Interest Income	38.0	88.3	96.8		
Less: Provision for Loan Losses	5.2	24.4	509.3		
Net Interest Income after Provision	32.8	63.9	-412.5		
Plus: Other Income	1.0	76.4	3.2		
Less: Other Expenses	26.7	179.7	150.8		
Net Income	7.1	-39.5	-560.1		

(1) FLBAs report to FCA on a semiannual basis rather than a quarterly basis. The next FLBA reports to FCA will be at and for the 6 months ending December 31, 1985.

(2) Quarterly PCA reports to FCA for the period ending September 30, 1985, are due in the agency on October 31, 1985.

Components may not add to exact totals due to rounding.

3.

Additional Financial Information
at and for the Quarter Ending September 30, 1985

	13 BCs	12 FICBs	12 FLBs	FLBAs(1)	PCAs(2)
	- - Three Months Ending September 30, 1985 - -				
Return on assets (%)	0.29	-0.87	-4.17		
Return on equity (%)	2.35	-7.89	-39.35		
Net interest margin (%)	1.58	2.03	0.75		
Net chargeoffs on loans ($ millions)	11.1	1.3	140.3		
Capital-to-assets ratio	0.13	0.11	0.10		
Debt-to-capital ratio	6.81	8.13	8.94		

Source: Reports of financial condition and performance.

(1) FLBAs report to FCA on a semiannual basis rather than a quarterly basis. The next FLBA reports to FCA will be at and for the 6 months ending December 31, 1985.

(2) Quarterly PCA reports to FCA for the period ending September 30, 1985, are due in the agency on October 31, 1985.

Components may not add to exact totals due to rounding.

Table 4

FLB Loan Performance
September 30, 1985

	1	2	3	4	5	6	7	8	9	10	11	12	Total
	Farm Credit District												
	Percent of Total Loans												
1. Performing	96.5	95.2	92.5	81.8	84.3	88.5	85.5	84.6	82.5	98.0	88.7	88.3	87.6
2. Formally restructured	0	*	*	*	0	*	*	*	0.1	0.1	0	0	*
3. Informally restructured	0	*	0	0	0	0	0.2	*	0	*	0	0	*
4. Other High Risk	2.5	3.4	4.8	5.6	12.5	4.1	4.4	4.8	7.8	1.6	7.2	7.8	5.6
5. Nonaccrual	1.0	1.3	2.6	12.6	3.2	7.4	9.9	10.6	9.7	0.2	4.2	3.9	6.7
VOLUME ($ million)	995.8	2,184.3	5,315.2	4,319.7	2,753.3	4,884.0	7,251.3	5,574.4	4,968.0	2,764.7	4,596.3	3,647.9	49,254.9
	Percent of Loan Numbers												
1. Performing	98.1	97.3	96.4	94.4	96.9	95.2	93	91.9	93.1	98.5	93.8	94.5	94.8
2. Formally restructured	0	*	*	*	*	0	*	*	*	*	*	0	*
3. Informally restructured	0	*	0	0	0	0	0	*	0	*	0	0	*
4. Other High Risk	1.5	2.4	3.1	3.4	2.6	4.8	5.1	5.9	4.2	1.4	5.0	4.9	3.9
5. Nonaccrual	0.4	0.3	0.5	2.2	0.5	A	2.0	2.2	2.7	0	1.1	0.6	1.2
NUMBER (000)	17.3	35.6	90.6	61.6	35.2	58.7	87.8	68.9	63.2	39.4	23.9	38.9	621.2

* Less than 0.1 percent
A Not available
Percentages may not sum to 100.0 due to rounding.

Exhibit 1-A.1
Federal Land Banks
Statement of Condition
Combined Totals
September 30, 1985
($ 000 Omitted)

Loans: Unmatured Principal	$ 45,340,695
Unmatured Extensions	19,468
Delinquent Principal and Advances	575,306
Loans in Process of Closing	22,092
Nonaccrual Loans	3,297,307
Accrued Interest Receivable on Loans	2,633,388
Gross Loan Items	51,888,257
Less: Allowance for Losses	915,640
Less: Deferred Proceeds of Loans	95,722
Less: Future Payment Funds	372,213
Less: Advance Payments	346,376
Less: Unamortized Loan Fees	19,143
Less: Unapplied Loan Payments	53,790
Net Loan Items	50,085,373
Cash	54,345
Investments: U.S. Government Securities (Par)	161,340
Securities Government Supervised Institutions (Par)	149,135
Other Securities and Federal Funds	1,683,548
Investment in DBC Bankers Acceptances (Par)	0
Unamortized Premium or Discount (Net)	-7,810
Unamortized Defer Gain/Loss Security Sales (Net)	870
Total Investment in Securities	1,987,083
Notes Receivable Farm Credit Banks and Other	141,383
Accounts Receivable - Other FC Banks	84,307
Accrued Interest Receivable - Other Farm Credit Banks	1,477
Accrued Interest Receivable - Investments	22,250
Acquired Property	757,980
Less: Allowance for Losses	83,322
Less: Accumulated Depreciation	0
Net Acquired Property	674,658
Land, Buildings, and Equipment	156,814
Less: Accumulated Depreciation	34,770
Net Land, Buildings, and Equipment	122,044
Prepaid Expenses and Other Assets	107,061
Total Assets	$ 53,279,980

Exhibit 1-A.2

Federal Land Banks
Statement of Condition
Combined Totals

September 30, 1985
($ 000 Omitted)

Drafts Outstanding	$ 3,985
Notes Payable: FLBAs	475,764
Other Farm Credit Banks	0
Consolidated Systemwide Notes	1,238,242
Commercial Banks and Other	239,006
Securities Sold Under Agreement to Repurchase	125,434
Total Notes Payable	2,078,445
Accounts Payable	96,788
Accrued Interest Payable	1,460,566
Miscellaneous Trust Accounts	58,162
Unmatured Consolidated and Systemwide Bonds	44,293,745
Less: Consolidated Bonds Owned	222,000
Net Consolidated and System Bonds Outstanding	44,071,745
Unmatured Farm Credit Investment Bonds Outstanding	99,153
Matured Farm Credit Investment Bonds Outstanding	0
Other Liabilities	51,493
Total Liabilities	47,920,336
Capital Stock: Class B - FLBAs	2,522,786
Class C - FLBAs	0
Participation Certificates - FLBAs	148,355
Total Capital Stock	2,671,140
Earned Net Worth: Legal Reserve	1,681,369
Surplus Reserve	128,010
Earned Surplus	879,125
Total Earned Net Worth	2,688,504
Total Net Worth	5,359,644
Liabilities and Net Worth	$ 53,279,980

Exhibit 1-B.1
Federal Land Banks
Combined Statement of Income
September 30, 1985
($ 000 Omitted)

Loan Interest Income: Mortgage Loans	$ 1,371,372
Notes Receivable Other Farm Credit Banks	1,858
Sales Contracts (Net)	318
Penalty Other Interest Income	24,528
Total Interest Income from Loans	1,398,076
Income From Investments (Net)	37,870
Compensation Income - Participations Sold	0
Appraisal and Loan Service Fees	2,741
Financially Related Services	361
Other Operating Income	72
Gross Earnings	1,439,120
Notes and Bonds Expense: Cost of Bonds	1,297,227
Interest on Notes Payable	35,380
Interest on Future Payment Funds	6,493
Total Cost of Borrowed Funds	1,339,100
Compensation Expense - Participations Purchased	0
Operating Expense	66,113
Total Expenses	1,405,213
Net Gain (Loss) from Operations	33,906
Other Add/Deduct: Gain (Loss) - Sale of Investment	-15
Income (Expense) - Office Building or Premises	-50
Income (Expense) - Land/Buildings (Investment)	5
Income (Expense) - Acquired Property	-1,843
Gain (Loss) - Disposition of Acquired Property	1,091
Provision for Losses - Acquired Property	-75,525
Income (Expense) - Mineral Reservations	6,777
Interest on Investments - Buildings/Premises	212
Other Gains (Losses)	-15,353
Total Other Additions and Deductions	-84,705
Net Gain (Loss) Before Provision for Losses	-50,799
Provision for Losses on Loans	509,318
Net Earnings	$ -560,117

Table 6

FICB Loan Performance
September 30, 1985

	Farm Credit District												
	1	2	3	4	5	6	7	8	9	10	11	12	Total
						Percent of Total Loans							
1. Performing	99.8	85.2	66.8	99.7	97.8	87.9	71.6	18.5	73.2	91.4	80.9	51.3	74.7
2. Formally restructured	0	0	2.6	0.1	0	0	8.7	0	2.9	0	11.8	0	3.9
3. Informally restructured	0	0	0	0	0	0	0	0	0	0	0	0	0
4. Other High Risk	0	14.6	30.0	0	2.0	11.8	19.5	79.7	23.6	8.2	6.0	47.4	20.8
5. Nonaccrual	0.2	0.2	0.6	0.2	0.2	0.3	0.3	1.9	0.2	0.4	1.3	1.3	0.7
VOLUME ($ million)	604.31	715.9	1,515.7	1,424.7	711.1	1,079.6	2,702.7	1,472.9	939.3	1,102.4	2631.5	832.8	15,733.2

Percentages may not sum to 100.0 due to rounding.

Table 7

Banks for Cooperatives Loan Performance
September 30, 1985

	Farm Credit District													
	1	2	3	4	5	6	7	8	9	10	11	12	CBC	Total
						Percent of Total Loans								
1. Performing	99.6	92.4	77.4	99.4	99.0	90.6	93.3	78.5	97.5	83.7	85.4	89.1	95.8	92.9
2. Formally restructured	0	0.1	0	0	0	0	0	0	0	5.8	0	0	0.2	0.2
3. Informally restructured	0	0	0	0	0	0	0	0.1	0	0.6	8.6	0	0	0.6
4. Other High Risk	0	5.0	15.9	0.3	0.2	8.8	6.3	20.0	2.1	6.1	0	10.3	2.5	4.6
5. Nonaccrual	0.4	2.5	6.8	0.3	0.8	0.6	0.4	1.4	0.4	3.7	6.0	0.6	1.6	1.7
VOLUME ($ million)	151.7	66.8	267.7	425.4	298.2	367.4	995.4	419.8	426.3	144.5	540.5	319.4	3,327.9	7,751.0
						Percent of Loan Numbers								
1. Performing	99.0	44.48	80.6	98.7	98.2	95.2	95.7	90.6	97.6	84.4	97.4	90.9	93.3	94.5
2. Formally restructured	0	11.1	0	0	0	0	0	0	0	3.2	2.0	0	1.0	0.3
3. Informally restructured	0	0	0	0	0	0	0	0	0	1.3	0	0	0	0.1
4. Other High Risk	0	33.3	14.9	1.3	0.9	3.6	3.6	7.1	2.0	8.4	0	7.4	3.0	3.9
5. Nonaccrual	1.0	11.1	4.5	0	0.9	1.2	0.7	2.1	0.4	2.6	0.7	1.7	2.1	1.1
NUMBER (000)	105	9	67	301	217	248	704	436	461	154	153	175	99	3,129

Percentages may not sum to 100.0 due to rounding.

Exhibit 1-C.1
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loans: Unmatured Principal	$ 980,781	$ 2,142,437	$ 5,142,965	$ 3,746,603	$ 2,645,301	$ 4,483,337
Unmatured Extensions	0	0	6,375	0	33	1,931
Delinquent Principal and Advances	4,464	10,550	25,566	27,046	17,173	36,315
Loans in Process of Closing	808	2,104	155	1,672	3,320	275
Nonaccrual Loans	9,720	29,204	140,105	544,370	87,522	362,128
Accrued Interest Receivable on Loans	20,162	58,271	275,437	239,348	154,173	262,947
Gross Loan Items	1,015,935	2,242,565	5,590,604	4,559,039	2,907,521	5,146,933
Less: Allowance for Losses	14,735	20,035	53,464	48,323	72,493	82,456
Less: Deferred Proceeds of Loans	1,422	6,677	22,793	3,126	878	1,507
Less: Future Payment Funds	0	0	0	0	0	0
Less: Advance Payments	279	22,735	56,179	54,075	62,394	46,592
Less: Unamortized Loan Fees	0	0	0	0	1,504	0
Less: Unapplied Loan Payments	1,480	0	7,152	20,778	11,456	14,022
Net Loan Items	998,018	2,193,118	5,451,015	4,432,737	2,758,794	5,002,375
Cash	2,791	4,107	223	6,658	5,600	5,220
Investments: U.S. Government Securities (Par)	0	1,365	0	24,000	22,325	2,500
Securities Government Supervised Institutions (Par)	0	0	30,625	15,555	12,410	0
Other Securities and Federal Funds	66,000	153,751	80,153	83,787	45,971	249,257
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	0	-8	-37	-847	4	-79
Unamortized Defer Gain/Loss Security Sales (Net)	0	0	282	299	0	290
Total Investment in Securities	66,000	155,107	111,022	122,792	80,710	251,966
Notes Receivable Farm Credit Banks and Other	5,087	8,992	277	21,205	22,000	511
Accounts Receivable	2,228	1,154	70	47,273	208	250
Accrued Interest Receivable - Other Farm Credit Banks	35	57	19	74	135	0
Accrued Interest Receivable - Investments	138	3,512	1,010	984	1,297	960
Acquired Property	3,233	6,112	74,523	59,168	181,307	72,263
Less: Allowance for Losses	43	157	6,303	1,125	33,890	0
Less: Accumulated Depreciation	0	0	0	0	0	0
Net Acquired Property	3,190	5,955	68,220	58,043	147,417	72,263
Land, Buildings, and Equipment	16,036	12,875	7,340	10,048	10,538	11,220
Less: Accumulated Depreciation	4,057	2,617	3,350	4,572	1,425	2,467
Net Land, Buildings, and Equipment	11,979	10,257	3,989	5,476	9,113	8,753
Prepaid Expenses and Other Assets	2,234	4,561	9,469	15,654	6,140	6,565
Total Assets	$ 1,091,700	$ 2,386,821	$ 5,645,314	$ 4,710,896	$ 3,031,415	$ 5,348,862

Exhibit 1-C.2
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Drafts Outstanding	$ 12	$ -89	$ 249	$ 452	$ 303	$ 158
Notes Payable: FLBAs	/ 14,782	57,965	40,974	49,315	3,145	19,104
Other Farm Credit Banks	0	0	0	0	0	0
Consolidated Systemwide Notes	67,398	73,789	0	0	23,875	193,218
Commercial Banks and Other	0	15,357	50,188	35,386	22,031	36,996
Securities Sold Under Agreement to Repurchase	0	0	0	4,875	0	0
Total Notes Payable	82,179	147,092	91,162	89,576	49,051	249,317
Accounts Payable	7,836	1,633	599	567	382	376
Accrued Interest Payable	27,137	57,348	162,749	136,561	85,921	146,062
Miscellaneous Trust Accounts	616	7,218	6,205	1,342	569	3,763
Unmatured Consolidated and Systemwide Bonds	849,925	1,802,100	4,721,388	4,177,791	2,649,800	4,419,500
Less: Consolidated Bonds Owned	0	0	47,000	100,000	25,000	0
Net Consolidated and System Bonds Outstanding	849,925	1,802,100	4,674,388	4,077,791	2,624,800	4,419,500
Unmatured Farm Credit Investment Bonds Outstanding	0	99,153	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	976	1,176	4,919	4,397	4,102	4,135
Total Liabilities	968,680	2,115,629	4,940,272	4,310,686	2,765,129	4,823,311
Capital Stock: Class B - FLBAs	53,768	104,538	249,331	235,719	135,451	263,845
Class C - FLBAs	0	0	0	0	0	0
Participation Certificates - FLBAs	6,269	14,100	39,429	9,049	13,691	5,369
Total Capital Stock	60,037	118,639	288,760	244,768	149,142	269,214
Earned Net Worth: Legal Reserve	62,191	76,686	216,915	134,697	77,803	160,885
Surplus Reserve	0	4,500	0	9,000	0	0
Earned Surplus	791	71,367	199,368	11,744	39,340	95,452
Total Earned Net Worth	62,982	152,553	416,283	155,442	117,143	256,337
Total Net Worth	123,020	271,192	705,043	400,209	266,286	525,551
Liabilities and Net Worth	$ 1,091,700	$ 2,386,821	$ 5,645,314	$ 4,710,896	$ 3,031,415	$ 5,348,862

Exhibit 1-C.3
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loans: Unmatured Principal	$ 6,447,983	$ 4,806,231	$ 4,361,868	$ 2,747,111	$ 4,363,773	$ 3,472,305
Unmatured Extensions	9,011	2,108	0	11	0	0
Delinquent Principal and Advances	79,703	174,541	125,020	1,246	38,875	34,807
Loans in Process of Closing	0	0	1,639	9,668	2,451	0
Nonaccrual Loans *	714,647	591,496	479,477	6,666	191,232	140,739
Accrued Interest Receivable on Loans	335,452	380,793	266,548	142,689	263,366	234,203
Gross Loan Items	7,586,795	5,955,170	5,234,552	2,907,392	4,859,697	3,882,054
Less: Allowance for Losses	150,781	187,696	151,100	43,415	53,074	38,067
Less: Deferred Proceeds of Loans	9,800	3,682	1,117	9,374	33,587	1,758
Less: Future Payment Funds	0	76,214	116,949	68,059	35,676	75,315
Less: Advance Payments	80,328	97	11,463	12,224	9	0
Less: Unamortized Loan Fees	17,638	0	0	0	0	0
Less: Unapplied Loan Payments	-8,321	3,866	2,536	-1,582	1,058	1,367
Net Loan Items	7,336,570	5,683,615	4,951,387	2,775,903	4,736,294	3,765,547
Cash	8,593	8,500	1,787	3,692	965	6,209
Investments: U.S. Government Securities (Par)	25,400	13,000	50,000	5,750	17,000	0
Securities Government Supervised Institutions (Par)	18,819	5,000	10,000	0	41,726	15,000
Other Securities and Federal Funds	213,356	171,804	153,865	230,873	162,633	72,100
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	-3,262	-11	-1	-609	-1,985	-964
Unamortized Defer Gain/Loss Security Sales (Net)	0	0	0	0	0	0
Total Investment in Securities	254,312	189,792	213,863	236,013	219,372	86,134
Notes Receivable Farm Credit Banks and Other	17,569	6,630	13,499	0	33,587	12,025
Accounts Receivable	18,132	4,212	5,039	1,229	3,883	779
Accrued Interest Receivable - Other Farm Credit Banks	24	341	568	0	214	11
Accrued Interest Receivable - Investments	2,881	3,095	1,925	4,741	1,296	413
Acquired Property	101,195	84,034	72,616	3,331	67,987	32,212
Less: Allowance for Losses	7,337	21,604	4,441	0	4,781	3,641
Less: Accumulated Depreciation	0	0	0	0	0	0
Net Acquired Property	93,858	62,430	68,175	3,331	63,206	28,571
Land, Buildings, and Equipment	15,168	8,350	18,813	9,864	6,996	29,567
Less: Accumulated Depreciation	4,857	3,800	1,834	910	1,866	3,014
Net Land, Buildings, and Equipment	10,312	4,550	16,980	8,954	5,129	26,553
Prepaid Expenses and Other Assets	9,222	8,235	16,784	5,967	7,302	14,927
Total Assets	$ 7,751,472	$ 5,971,399	$ 5,290,006	$ 3,039,829	$ 5,071,249	$ 3,941,169

Exhibit 3-A.1
Federal Intermediate Credit Banks
Statement of Condition
Combined Totals
September 30, 1985
($000 Omitted)

Loans and Discounts: PCAs	$ 14,877,905
Other Financing Institutions	699,047
Participation Loans - PCAs	19,246
Other Participations	28,472
Sales Contracts, Notes, Etc.	3,857
Nonaccrual Loans	104,662
Accrued Interest Receivable on Loans	382,879
Gross Loan and Discount Items	16,116,067
Less: Allowance for Losses	51,077
Less: Unapplied Loan Payments	21,191
Net Loan and Discouunt Items	16,043,869
Cash	58,468
Investments: U.S. Government Securities (Par)	109,338
Securities Government Supervised Institutions (Par)	115,952
Other Securities and Federal Funds	1,455,703
Investment in DBC Bankers Acceptances (Par)	0
Unamortized Premium or Discount (Net)	-7,716
Unamortized Defer Gain/Loss Security Sales (Net)	1,288
Total Investment in Securities	1,674,564
Investments in PCAs: Paid in Surplus (Net)	600
Class A Stock	25,563
Class B Stock	0
Class D Stock	20,646
Total Investments in PCAs	46,808
Notes Receivable Farm Credit Banks and Other	78,388
Accounts Receivable	9,742
Accrued Interest Receivable - Other Farm Credit Banks	394
Accrued Interest Receivable - Investments	15,576
Acquired Property: Investments and Operations	15,491
Less: Allowance for Losses	2,296
Less: Accumulated Depreciation	2
Net Acquired Property	13,193
Land, Buildings, and Equipment	78,213
Less: Accumulated Depreciation	13,735
Net Land, Buldings, and Equipment	64,478
Prepaid Expenses and Other Assets	26,847
Total Assets	$ 18,032,328

Exhibit 3-A.2
Federal Intermediate Credit Banks
Statement of Condition
Combined Totals
September 30, 1985
($000 Omitted)

Notes Payable: Other Farm Credit Banks	$ 779
Consolidated Systemwide Notes	2,828,922
Commercial Banks and Other	108,771
Securities Sold Under Agreement to Repurchase	14,908
Total Notes Payable	2,953,380
Accounts Payable	126,712
Accrued Interest Payable	386,555
Unmatured Consolidated and Systemwide Bonds	12,628,405
Less: Consolidated Bonds Owned	88,199
Net Consolidated and System Bonds Outstanding	12,540,206
Unmatured Farm Credit Investment Bonds Outstanding	28,795
Matured Farm Credit Investment Bonds Outstanding	0
Other Liabilities	20,992
Total Liabilities	16,056,640
Capital Stock: Class B Stock - PCAs	1,343,810
Participation Certificates	68,839
Total Capital Stock	1,412,649
Earned Net Worth: Surplus Reserved	63,067
Surplus Unallocated	30,913
Legal Reserve	447,785
Reserve for Contingencies - Unallocated	33,197
Undistributed Earnings	-11,921
Total Earned Net Worth	563,039
Total Net Worth	1,975,688
Total Liabilities and Net Worth	$ 18,032,328

Exhibit 3-B.1
Federal Intermediate Credit Banks
Statement of Condition
Combined Totals
September 30, 1985
($000 Omitted)

Loan Interest Income: Loans and Discounts	$	422,901
Sales Contracts		96
Notes Receivable Other Farm Credit Banks		549
Other Interest Income		43
Total Interest Income from Loans		423,589
Income From Investments (Net)		28,806
Other Operating Income		76,376
Gross Earnings		528,772
Notes and Bonds Expense: Cost of Bonds		315,101
Interest on Notes Payable		48,997
Total Cost of Borrowed Funds		364,098
Compensation Expense - Participations Purchased		14
Operating Expense		25,720
Total Expenses		389,832
Net Gain (Loss) from Operations		138,940
Other Add/Deduct: Gain (Loss) - Sale of Investment		304
Income (Expense) - Office Building or Premises		11
Income (Expense) - Land/Buildings (Investment)		3
Income (Expense) - Acquired Property		-87
Gain (Loss) - Disposition of Acquired Property		28
Provision for Losses - Acquired Property		-449
Income (Expense) - Mineral Reservations		26
Other Gains (Losses)		-153,839
Total Other Additions and Deductions		-154,006
Net Gain (Loss) Before Provision for Losses		-15,066
Provision for Losses on Loans		24,425
Net Earnings	$	-39,491

Exhibit 1-C.4
Federal Land Banks
Statement of Condition
September 30, 1985
($ 000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Drafts Outstanding	$ 0	$ 0	$ 748	$ 0	$ 937	$ 1,216
Notes Payable: FLBAs	77,979	5,566	30,237	95,490	24,238	56,988
Other Farm Credit Banks	0	0	0	0	0	0
Consolidated Systemwide Notes	271,329	19,976	69,567	165,623	218,848	134,620
Commercial Banks and Other	52,027	425	0	0	273	26,323
Securities Sold Under Agreement to Repurchase	19,689	17,925	60,638	22,307	0	0
Total Notes Payable	421,025	43,891	160,442	283,420	243,359	217,931
Accounts Payable	92	47,823	37,301	163	25	141
Accrued Interest Payable	213,661	170,008	129,799	85,367	139,196	106,756
Miscellaneous Trust Accounts	26,367	9,041	2,863	1,390	-1,996	785
Unmatured Consolidated and Systemwide Bonds	6,203,400	5,290,000	4,423,793	2,361,350	4,206,700	3,187,998
Less: Consolidated Bonds Owned	0	50,000	0	0	0	0
Net Consolidated and System Bonds Outstanding	6,203,400	5,240,000	4,423,793	2,361,350	4,206,700	3,187,998
Unmatured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	5,663	5,089	7,994	3,044	4,094	5,903
Total Liabilities	6,870,208	5,515,853	4,762,940	2,734,735	4,592,316	3,520,729
Capital Stock: Class B - FLBAs	359,623	286,483	242,668	141,794	258,948	190,619
Class C - FLBAs	0	0	0	0	0	0
Participation Certificates - FLBAs	20,936	8,037	12,597	11,005	2,039	5,832
Total Capital Stock	380,559	294,519	255,265	152,800	260,987	196,450
Earned Net Worth: Legal Reserve	291,562	161,027	197,191	74,844	113,050	114,516
Surplus Reserve	61,310	0	0	47,500	0	5,700
Earned Surplus	147,834	0	74,610	29,950	104,896	103,774
Total Earned Net Worth	500,706	161,027	271,801	152,294	217,946	223,990
Total Net Worth	881,265	455,546	527,066	305,093	478,933	420,440
Total Liabilities and Net Worth	$ 7,751,472	$ 5,971,399	$ 5,290,066	$ 3,039,829	$ 5,071,249	$ 3,941,169

Exhibit 1-D.1
Federal Land Banks
Statement of Income
Three Months Ending September 30, 1985
($ 000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loan Interest Income: Mortgage Loans	$ 29,772	$ 61,976	$ 152,102	$ 104,432	$ 77,288	$ 131,850
Notes Receivable Other Farm Credit Banks	73	154	0	217	408	21
Sales Contracts (Net)	0	0	0	0	0	0
Penalty and Other Interest Income	496	666	1,230	291	2,008	412
Total Interest Incomerom Loans	30,342	62,796	153,332	104,940	79,704	132,283
Income from Investments (Net)	1,405	3,319	2,111	2,498	1,575	3,538
Compensation Income - Participations Sold	0	0	0	0	0	0
Appraisal and Loan Service Fees	0	1	772	0	275	261
Financially Related Services	0	10	0	57	73	11
Other Operating Income	28	20	0	0	0	0
Gross Earnings	31,774	66,146	156,215	107,496	81,627	136,093
Notes and Bonds Expense: Cost of Bonds	23,548	54,843	137,951	123,999	76,949	126,453
Interest on Notes Payable	1,874	2,553	2,351	1,633	1,172	42
Interest on Future Payment Funds	2	0	0	0	0	0
Total Cost of Borrowed Funds	25,424	57,396	140,302	125,632	78,122	126,495
Compensation Expense - Participations Purchased	0	0	0	0	0	0
Operating Expense	3,184	4,228	7,921	5,153	5,218	8,190
Total Expenses	28,608	61,624	148,223	130,785	83,340	134,685
Net Gain (Loss) from Operations	3,166	4,521	7,992	-23,289	-1,712	1,408
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	-15	0	0	0	0
Income (Expense) Office Building and Premises	0	1	13	0	0	0
Income (Expense) Land/Buildings (Investment)	0	0	2	0	-7	0
Income (Expense) - Acquired Property	1	-32	-7	134	357	-60
Gain (Loss) - Disposition of Acquired Property	5	9	248	-615	118	26
Provision for Losses - Acquired Property	0	-47	-2,268	-9,028	-28,558	-11,230
Income (Expense) - Mineral Reservations	0	1	0	1	2,375	366
Interest on Investment - Buildings/Premises	25	128	59	0	0	0
Other Gains (Losses)	-974	-2,078	-5,278	-5,441	32,366	-4,979
Total Other Additions and Deductions	-944	-2,036	-7,233	-14,951	6,649	-15,879
Net Gain (Loss) before Provision for Losses	2,221	2,484	758	-38,240	4,937	-14,471
Provision for Losses	-260	-262	20,650	35,220	39,161	35,000
Net Earnings	$ 2,482	$ 2,747	$ -19,891	$ -73,461	$ -34,223	$ -49,471

Exhibit I-D.2
Federal Land Banks
Statement of Income
Three Months Ending September 30, 1985
($ 000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loan Interest Income: Mortgage Loans	$ 205,531	$ 166,598	$ 129,141	$ 78,016	$ 131,195	$ 103,472
Notes Receivable Other Farm Credit Banks	171	3	302	1	484	23
Sales Contracts (Net)	0	231	73	0	0	14
Penalty and Other Interest Income	3,646	3,929	7,899	86	1,153	2,711
Total Interest Income from Loans	209,347	170,762	137,416	78,102	132,832	106,220
Income from Investments (Net)	4,418	4,210	4,572	4,584	3,777	1,865
Compensation Income - Participations Sold	0	0	0	0	0	0
Appraisal and Loan Service Fees	404	16	0	42	964	6
Financially Related Services	32	178	0	0	0	0
Other Operating Income	3	16	3	0	1	0
Gross Earnings	214,204	175,181	141,991	82,728	137,574	108,091
Notes and Bonds Expense: Cost of Bonds	181,543	158,963	128,077	68,600	122,823	93,478
Interest on Notes Payable	7,296	1,226	4,491	5,308	3,734	3,700
Interest on Future Payment Funds	0	2,433	0	1,891	0	2,167
Total Cost of Borrowed Funds	188,839	162,622	132,568	75,798	126,557	99,345
Compensation Expense - Participations Purchases	0	0	0	0	0	0
Operating Expense	10,276	8,184	8,317	2,318	-1,617	4,742
Total Expenses	199,115	170,806	140,885	78,116	124,939	104,088
Net Gain (Loss) from Operations	15,090	4,375	1,106	4,612	12,634	4,003
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	0	0	0
Income (Expense) Office Building and Premises	0	11	-2	0	0	-72
Income (Expense) Land/Buildings (Investment)	0	3	0	0	0	9
Income (Expense) - Acquired Property	3	-72	-1,191	-82	-284	-603
Gain (Loss) - Disposition of Acquired Property	0	-47	1,288	-25	-6	94
Provision for Losses - Acquired Property	-1,623	-18,778	-381	0	-3,118	-486
Income (Expense) - Mineral Reservations	1,306	38	1,511	782	63	334
Interest on Investment - Buildings/Premises	0	0	0	0	0	0
Other Gains (Losses)	-7,272	-6,157	-4,976	-2,567	-4,512	-3,476
Total Other Additions and Deductions	-7,587	-25,005	-3,753	-1,894	-7,859	-4,203
Net Gain (Loss) before Provision for Losses	7,502	-20,629	-2,647	2,717	4,775	-200
Provision for Losses	83,983	177,253	115,884	600	2,300	-209
Net Earnings	$ -76,480	$ -197,882	$ -118,531	$ 2,117	$ 2,475	$ 9

EXHIBIT 1-E.1
FEDERAL LAND BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE[1]	JACKSON	ST. LOUIS[1]
Nonperforming Loans ($ millions)	34.7	104.4	397.0	787.0	286.2	706.1
Formally Restructured	0	0.3	1.1	1.4	0.1	0
Other Restructured & Reduced Rate	0	0.3	0	0	0	0
Other High Risk	25.0	74.6	255.8	241.2	198.6	344.0
Nonaccrual	9.7	29.2	140.1	544.4	87.5	362.1
Net Loan Chargeoffs ($ millions)	a	0.9	4.7	22.0	8.4	30.0
Selected Ratios						
Return on Assets (%)	0.90	0.46	(1.40)	(6.04)	(4.45)	(3.68)
Return on Equity (%)	7.90	4.06	(11.08)	(65.98)	(47.64)	(35.65)
Net Interest Margin (%)	2.38	1.49	1.13	(1.69)	0.45	0.77
Capital to Assets	0.11	0.11	0.12	0.08	0.09	0.10
Debt to Capital	7.87	7.80	7.00	10.77	10.38	9.18

Components may not add to totals due to rounding.
* Indicates less than $50,000
a Indicates net recovery of less than $50,000
[1] Indicates preliminary data, revisions expected

EXHIBIT 1-E.2
FEDERAL LAND BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	ST. PAUL	OMAHA	WICHITA[1]	TEXAS	SACRAMENTO	SPOKANE
Nonperforming Loans ($ millions)	1,052.3	860.2	867.4	55.5	521.5	426.0
Formally Restructured	*	1.5	2.5	3.4	0	0
Other Restructured & Reduced Rate	15.8	0.5	0	0.5	0	0
Other High Risk	321.9	266.7	385.4	44.9	330.3	285.3
Nonaccrual	714.6	591.5	479.5	6.7	191.2	140.7
Net Loan Chargeoffs ($ millions)	11.8	34.7	19.1	(0.3)	9.3	(0.3)
Selected Ratios						
Return on Assets (%)	(3.93)	(12.87)	(8.84)	0.28	0.20	0
Return on Equity (%)	(33.11)	(140.05)	(79.52)	2.79	2.06	0.01
Net Interest Margin (%)	1.42	0.90	0.78	0.93	0.86	0.97
Capital to Assets	0.11	0.08	0.10	0.10	0.09	0.11
Debt to Capital	7.80	12.11	9.04	8.96	9.59	8.37

Components may not add to totals due to rounding.
* Indicates less than $50,000
1 Indicates preliminary data, revisions expected

Exhibit 3-C.1
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loans and Discounts: PCAs	$ 602,683	$ 665,194	$ 1,505,039	$ 1,414,844	$ 580,804	$ 1,053,535
Other Financing Institutions	633	44,180	1,788	6,450	115,037	22,911
Participation Loans - PCAs	0	5,037	0	0	13,941	267
Other Participations	0	0	0	0	0	0
Sales Contracts, Notes, Etc.	0	0	0	0	0	0
Nonaccrual Loans	1,033	1,520	8,869	3,425	1,408	2,924
Accrued Interest Receivable on Loans	6	5,704	14,283	84,550	17,571	26,483
Gross Loan and Discount Items	604,354	721,636	1,529,979	1,509,269	728,762	1,106,119
Less: Allowance for Losses	0	766	5,966	11,881	3,527	3,359
Less: Unapplied Loan Payments	0	0	0	0	0	9,293
Net Loan and Discount Items	604,354	720,869	1,524,013	1,497,388	725,235	1,093,468
Cash	2,556	2,075	285	6,679	456	8,996
Investments: U.S. Government Securities (Par)	0	1,770	0	8,000	0	0
Securities Government Supervised Institutions (Par)	0	0	5,600	23,499	0	0
Other Securities and Federal Funds	64,000	139,257	100,716	51,664	25,479	133,767
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	0	-13	-52	-561	0	0
Unamortized Defer Gain/Loss Security Sales (Net)	0	0	271	253	0	0
Total Investment in Securities	64,000	141,013	106,535	82,853	25,479	133,767
Investments in PCAs: Paid in Surplus (Net)	0	0	0	0	0	600
Class A Stock	0	0	0	11,640	2,589	7,333
Class B Stock	0	0	0	0	0	0
Class D Stock	0	0	4,376	0	8,000	0
Total Investments in PCAs	0	0	4,376	11,640	10,589	7,933
Notes Receivable Farm Credit Banks and Other	5,183	11,018	0	20,000	23,601	0
Accounts Receivable	237	98	345	3,539	50	1,214
Accrued Interest Receivable - Other Farm Credit Banks	35	23	0	36	20	0
Accrued Interest Receivable - Investments	107	3,571	858	952	51	584
Acquired Property: Investments and Operations	0	0	306	0	51	546
Less: Allowance for Losses	0	0	45	0	0	0
Less: Accumulated Depreciation	0	0	0	0	0	0
Net Acquired Property	0	0	260	0	51	546
Land, Buildings, and Equipment	1,135	0	2,539	4,032	8,157	10,353
Less: Accumulated Depreciation	234	0	989	819	611	2,006
Net Land, Buildings, and Equipment	901	0	1,550	3,213	7,497	8,347
Prepaid Expenses and Other Assets	606	968	1,885	4,354	2,121	2,095
Total Assets	$ 677,979	$ 879,636	$ 1,640,106	$ 1,630,655	$ 795,150	$ 1,256,949

Exhibit 3-C.2
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Notes Payable: Other Farm Credit Banks	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Consolidated Systemwide Notes	117,072	95,625	30,976	39,847	102,593	152,000
Commercial Banks and Other	0	5,362	12,224	11,748	5,267	8,226
Securities Sold Under Agreement to Repurchase	0	0	0	4,875	0	0
Total Notes Payable	117,072	100,988	43,200	56,470	107,860	160,225
Accounts Payable	6,017	754	1,689	585	187	59
Accrued Interest Payable	14,334	17,840	37,556	37,810	14,926	25,871
Unmatured Consolidated and Systemwide Bonds	480,015	651,000	1,335,250	1,267,827	565,051	916,000
Less: Consolidated Bonds Owned	0	0	38,000	0	0	0
Net Consolidated and System Bonds Outstanding	480,015	651,000	1,297,250	1,267,827	565,051	916,000
Unmatured Farm Credit Investment Bonds Outstanding	0	28,783	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	39	216	1,173	251	114	1,306
Total Liabilities	617,477	799,580	1,380,868	1,362,943	688,138	1,103,461
Capital Stock: Class B Stock - PCAs	42,209	48,187	170,812	199,213	67,826	103,388
Participation Certificates	118	3,626	178	613	9,410	1,708
Total Capital Stock	42,327	51,813	170,991	199,826	77,236	105,096
Earned Net Worth: Surplus Reserved	4,593	4,177	3,701	5,273	4,105	4,819
Surplus Unallocated	367	431	2,092	3,153	1,332	2,880
Legal Reserve	13,214	17,031	70,252	57,205	20,950	34,855
Reserve for Contingencies - Unallocated	0	2,739	1,714	0	0	4,409
Undistributed Earnings	0	3,863	10,490	2,255	3,388	1,430
Total Earned Net Worth	18,175	28,242	88,249	67,886	29,776	48,393
Total Net Worth	60,502	80,555	259,240	267,713	107,012	153,488
Total Liabilities and Net Worth	$ 677,979	$ 879,636	$ 1,640,108	$ 1,630,655	$ 795,150	$ 1,256,949

Exhibit 3-C.3
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loans and Discounts: PCAs	$ 2,605,400	$ 1,367,830	$ 852,929	$ 915,789	$ 2,523,712	$ 790,146
Other Financing Institutions	90,039	77,533	82,150	180,934	73,955	3,438
Participation Loans - PCAs	0	0	0	0	0	0
Other Participations	0	0	0	0	0	28,472
Sales Contracts, Notes, Etc.	0	68	1,999	1,789	0	0
Nonaccrual Loans	7,337	27,507	2,258	3,859	33,799	10,723
Accrued Interest Receivable on Loans	76,110	42,675	8,306	8,902	88,871	9,418
Gross Loan and Discount Items	2,778,886	1,515,613	947,642	1,111,273	2,720,337	842,196
Less: Allowance for Losses	3,876	2,642	11,127	1,394	1,200	5,268
Less: Unapplied Loan Payments	9,871	410	0	1,617	0	0
Net Loan and Discount Items	2,765,139	1,512,561	936,514	1,108,262	2,719,137	836,928
Cash	11,968	1,918	3,257	2,137	14,095	4,045
Investments: U.S. Government Securities (Par)	65,000	6,300	10,000	3,268	10,000	5,000
Securities Government Supervised Institutions (Par)	34,537	1,000	18,500	0	11,000	21,817
Other Securities and Federal Funds	226,067	140,513	44,743	335,946	134,106	59,444
Investment in DBC Bankers Acceptances (Par)	0	0	0	0	0	0
Unamortized Premium or Discount (Net)	-4,286	35	279	-2,017	-55	-1,040
Unamortized Defer Gain/Loss Security Sales (Net)	422	107	0	236	0	0
Total Investment in Securities	321,739	147,955	73,522	337,431	155,050	85,220
Investments in PCAs: Paid in Surplus (Net)	0	0	0	0	0	0
Class A Stock	0	0	0	0	0	4,000
Class B Stock	0	0	0	0	0	0
Class D Stock	0	0	7,250	1,020	0	0
Total Investments in PCAs	0	0	7,250	1,020	0	4,000
Notes Receivable Farm Credit Banks and Other	6,732	987	21	0	846	10,000
Accounts Receivable	1,442	3,142	449	139	525	-576
Accrued Interest Receivable - Other Farm Credit Banks	0	176	61	0	8	34
Accrued Interest Receivable - Investments	2,378	1,615	1,237	1,427	2,215	581
Acquired Property: Investments and Operations	0	2,054	0	3,471	9,064	0
Less: Allowance for Losses	0	431	0	1,819	0	0
Less: Accumulated Depreciation	0	0	0	2	0	0
Net Acquired Property	0	1,622	0	1,650	9,064	0
Land, Buildings, and Equipment	13,132	3,853	17,896	9,726	6,167	1,223
Less: Accumulated Depreciation	3,856	1,083	1,337	637	1,854	259
Net Land, Buildings, and Equipment	9,276	2,770	16,559	9,089	4,313	964
Prepaid Expenses and Other Assets	3,678	1,686	1,455	3,031	3,177	1,793
Total Assets	$ 3,122,352	$ 1,674,431	$ 1,040,325	$ 1,464,186	$ 2,908,430	$ 942,988

Exhibit 3-C.4
Federal Intermediate Credit Banks
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Notes Payable: Other Farm Credit Banks	$ 779	$ 0	$ 0	$ 0	$ 0	$ 0
Consolidated Systemwide Notes	531,911	267,661	99,737	451,347	748,572	191,582
Commercial Banks and Other	23,233	747	0	8,761	24,296	8,908
Securities Sold Under Agreement to Repurchase	0	7,255	0	2,778	0	0
Total Notes Payable	555,924	275,662	99,737	462,886	772,867	200,489
Accounts Payable	584	105,189	9,109	32	134	3,233
Accrued Interest Payable	73,150	35,934	24,523	25,531	59,158	19,922
Unmatured Consolidated and Systemwide Bonds	2,175,524	1,153,896	754,459	840,653	1,859,680	629,050
Less: Consolidated Bonds Owned	194	50,000	0	0	0	5
Net Consolidated and System Bonds Outstanding	2,175,330	1,103,896	754,459	840,653	1,859,680	629,045
Unmatured Farm Credit Investment Bonds Outstanding	12	0	0	0	0	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Other Liabilities	12,023	346	715	2,889	553	1,368
Total Liabilities	2,817,022	1,521,028	888,543	1,331,990	2,692,392	854,058
Capital Stock: Class B Stock - PCAs	204,593	135,681	97,226	57,557	147,251	69,868
Participation Certificates	11,081	7,779	11,738	13,764	4,706	4,116
Total Capital Stock	215,675	143,460	108,964	71,321	151,957	73,984
Earned Net Worth: Surplus Reserved	7,049	6,069	5,257	7,593	4,541	5,890
Surplus Unallocated	1,818	1,244	1,507	14,007	1,260	821
Legal Reserve	70,275	48,538	36,055	23,636	49,906	5,868
Reserve for Contingencies - Unallocated	10,512	0	2,435	7,139	4,249	0
Undistributed Earnings	0	-45,906	-2,434	8,500	4,127	2,367
Total Earned Net Worth	89,655	9,943	42,819	60,875	64,081	14,946
Total Net Worth	305,329	153,403	151,782	132,196	216,038	88,930
Total Liabilities and Net Worth	$ 3,122,352	$ 1,674,431	$ 1,040,325	$ 1,464,186	$ 2,908,430	$ 942,988

Exhibit 3-D.1
Federal Intermediate Credit Banks
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loan Interest Income: Loans and Discounts	$ 15,179	$ 17,575	$ 45,255	$ 35,408	$ 17,602	$ 26,499
Sales Contracts	0	0	0	0	0	0
Notes Receivable Other Farm Credit Banks	71	168	0	58	74	0
Other Interest Income	1	0	0	0	0	0
Total Interest Income from Loans	15,251	17,743	45,255	35,466	17,676	26,499
Income From Investments (Net)	1,240	2,859	1,814	1,603	211	1,722
Other Operating Income	155	4	0	0	0	0
Gross Earnings	16,645	20,605	47,069	37,069	17,887	28,221
Notes and Bonds Expense: Cost of Bonds	11,205	15,578	32,822	29,182	13,149	20,171
Interest on Notes Payable	2,219	1,728	1,104	601	1,333	3,029
Total Cost of Borrowed Funds	13,424	17,307	33,925	29,782	14,481	23,200
Compensation Expense - Participations Purchased	0	0	0	0	0	0
Operating Expense	1,391	1,434	1,627	2,214	1,404	2,489
Total Expenses	14,815	18,741	35,553	31,997	15,885	25,689
Net Gain (Loss) from Operations	1,830	1,864	11,517	5,072	2,002	2,532
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	0	367	0
Income (Expense) - Office Building or Premises	20	0	0	0	-7	0
Income (Expense) - Land/Buildings (Investment)	0	0	0	0	0	0
Income (Expense) - Acquired Property	0	0	1	0	0	-1
Gain (Loss) - Disposition of Acquired Property	0	0	0	0	0	0
Provision for Losses - Acquired Property	0	0	-41	0	0	-35
Income (Expense) - Mineral Reservations	0	0	0	0	0	0
Other Gains (Losses)	-661	-743	-1,934	-2,928	-797	-2,503
Total Other Additions and Deductions	-641	-743	-1,975	-2,928	-438	-2,540
Net Gain (Loss) Before Provision for Losses	1,189	1,120	9,541	2,143	1,563	-8
Provision for Losses on Loans	0	249	2,762	4,814	302	0
Net Earnings	$ 1,189	$ 871	$ 6,778	$ -2,670	$ 1,261	$ -8

Exhibit 3-D.2
Federal Intermediate Credit Banks
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane
Loan Interest Income: Loans and Discounts	$ 76,234	$ 42,873	$ 25,898	$ 27,707	$ 69,086	$ 23,587
Sales Contracts	0	2	55	39	0	0
Notes Receivable Other Farm Credit Banks	64	1	0	0	38	74
Other Interest Income	0	17	0	0	26	0
Total Interest Income from Loans	76,298	42,892	25,953	27,746	69,149	23,661
Income From Investments (Net)	5,878	2,042	1,368	5,209	3,245	1,616
Other Operating Income	5	76,208	4	0	0	0
Gross Earnings	82,181	121,142	27,325	32,955	72,394	25,278
Notes and Bonds Expense: Cost of Bonds	58,763	28,899	19,000	20,981	48,535	16,817
Interest on Notes Payable	9,049	4,594	1,832	6,928	13,358	3,224
Total Cost of Borrowed Funds	67,811	33,493	20,832	27,909	61,893	20,040
Compensation Expense - Participations Purchased	0	0	0	0	0	14
Operating Expense	4,420	2,197	2,606	1,747	2,467	1,722
Total Expenses	72,232	35,690	23,438	29,656	64,360	21,777
Net Gain (Loss) from Operations	9,949	85,452	3,887	3,299	8,034	3,501
Other Add/Deduct: Gain (Loss) - Sale of Investments	-62	0	0	0	0	0
Income (Expense) - Office Building or Permises	0	0	0	0	0	0
Income (Expense) - Land/Buildings (Investment)	0	3	0	0	0	0
Income (Expense) - Acquired Property	0	-7	0	-12	-65	0
Gain (Loss) - Disposition of Acquired Property	0	0	0	28	0	0
Provision for Losses - Acquired Property	0	-383	0	11	0	0
Income (Expense) - Mineral Reservations	0	0	0	26	0	0
Other Gains (Losses)	-17,748	-120,978	-1,246	-1,465	-2,824	-1
Total Other Additions and Deductions	-17,811	-121,368	-1,246	-1,413	-2,890	-1
Net Gain (Loss) Before Provision for Losses	-7,862	-35,915	2,639	1,886	5,143	3,499
Provision for Losses on Loans	1,459	1,992	10,692	55	600	1,5000
Net Earnings	$ -9,321	$ -37,907	$ -8,052	$ 1,831	$ 4,543	$ 1,999

Exhibit 5-A.1
Banks for Cooperatives
Combined Statement of Condition
September 30, 1985
($000 Omitted)

Loans to Cooperatives: Seasonal Loans	$2,739,731
Term	4,554,347
Commodity	153,295
Acceptances	89,823
Subtotal	7,537,197
Less: Participations	0
Less: Acceptances Discounted to Other FC Banks	0
Less: Unapplied Loan Payments	6,956
Less: Unearned Income (Acceptances)	1,109
Total Loans to Cooperative Associations	7,529,132
Nonaccrual Loans	130,477
Sales Contracts, Notes, Etc.	91,441
Accrued Interest Receivable on Loans	153,548
Gross Loan Items	7,904,598
Less: Allowance for Losses	122,383
Net Loan Items	7,782,215
Cash	19,904
Investments: U.S. Government Securities (Par)	6,800
Securities Government Supervised Institutions (Par)	41,954
Other Securities and Federal Funds	1,454,841
Unamortized Premium or Discount (Net)	-3,629
Total Investment in Securities	1,499,965
Investments in Central Bank for Cooperatives	0
Investments in Other Banks for Cooperatives	0
Investments in DBC Bankers Acceptances (Net)	0
Notes Receivable Farm Credit Banks and Other	33,860
Accounts Receivable	11,816
Accrued Interest Receivable - Other Farm Credit Banks	1,001
Accrued Interest Receiviable - Investments	7,900
Acquired Property	6,678
Less: Accumulated Depreciation	87
Less: Allowance for Losses	263
Net Acquired Property	6,328
Land, Buildings, and Equipment	52,838
Less: Accumulated Depreciation	9,140
Net Land, Buildings, and Equipment	43,699
Customers Liability on Acceptances Outstanding	0
Prepaid Expenses and other Assets	28,635
Total Assets	$9,435,322

Exhibit 5-A.2

Banks for Cooperatives
Combined Statement of Condition
September 30, 1985
($000 Omitted)

Notes Payable: Other Farm Credit Banks	$ 219,360
Consolidated Systemwide Notes	3,435,846
Commercial banks and Other	24,470
Securities Sold Under Agreement to Repurchase	25,068
Total Notes Payable	3,704,745
Accounts Payable	22,004
Accrued Interest Payable	127,738
Unmatured Consolidated and Systemwide Bonds	4,248,881
Less: Consolidated Bonds Owned	35,000
Net Consolidated and System Bonds Outstanding	4,213,881
Unmatured Farm Credit Investment Bonds Outstanding	148,123
Matured Farm Credit Investment Bonds Outstanding	0
Capital Stock and Equities Called For Retirement	1,775
Bankers Liability on Acceptances Outstanding	0
Other Liabilities	9,559
Total Liabilities	8,227,825
Capital Stock: Class B - All	475
Class C - District Banks	0
Class C - Cooperative Associations	792,763
Class D - All	1,127
Other - Cooperative Associations	1,530
Class C - Subscribed - Cooperative Associations	36,484
Class C - Subscribed - District Banks	0
Total Capital Stock	832,378
Earned Net Worth: Surplus Reserved	88,111
Surplus Allocated to Cooperative Associations	198,810
Surplus Allocated to District Banks	0
Surplus Unallocated	38,710
Undistributed Earnings	49,488
Total Earned Net Worth	375,119
Total Net Worth	1,207,497
Total Liabilities and Net Worth	$9,435,322

Exhibit 5-B.1
Banks for Cooperatives
Combined Statement of Income
September 30, 1985
($000 Omitted)

Loan Interest Income: Cooperative Associations	$196,928
Sales Contracts	2,281
Notes Receivable Other Farm Credit Banks	373
Other Interest Income	890
Total Interest Income from Loans	200,472
Income from Investments (Net)	31,934
Compensation Income - Participations Sold	0
Appraisal and Loan Service Fees	3
Financially Related Services	25
Customers Draft Accepted Fees	0
Letters of Credit Issued Fees	975
Income from Distribution of Earnings of Central BC	0
Income from Dist. of Earnings of Other District Banks	0
Gross Earnings	233,408
Notes and Bonds Expense: Cost of Bonds	123,197
Interest on Notes Payable	71,174
Total Cost of Borrowed Funds	194,371
Compensation Expense - Participations Purchased	0
Operating Expense	16,417
Total Expenses	210,788
Net Gain (Loss) from Operations	22,620
Other Add/Deduct: Gain (Loss) - Sale of Investment	-126
Income (Expense) Acquired Property	10
Gain (Loss) - Disposition of Acquired Property	1
Provision for Losses - Acquired Property	0
Income (Expense) Office Building or Premises	102
Income (Expense) Land/Buildings (Investment)	-2
Other Gains (Losses)	-9,744
Other Income (Expense)	61
Total Other Additions and Deductions	-9,701
Net Gain (Loss) Before Provision for Losses	12,919
Provision for Losses	-5,240
Net Earnings before Income Taxes	7,677
Less: Federal and Other Income Taxes	548
Net Earnings	$7,129

EXHIBIT 3-E.1

FEDERAL INTERMEDIATE CREDIT BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS
Nonperforming Loans ($ millions)	1.0	106.2	503.7	4.3	15.3	130.8
Formally Restructured	0	0	40.0	0.9	0	0
Other Restructured & Reduced Rate	0	0	0	0	0	0
Other High Risk	0	104.7	454.8	0	13.9	127.9
Nonaccrual	1.0	1.5	8.9	3.4	1.4	2.9
Net Loan Chargeoffs ($ millions)	0	0	0.9	0	#	#
Selected Ratios						
Return on Assets (%)	0.71	0.40	1.58	(0.66)	0.68	0
Return on Equity (%)	7.68	4.38	10.60	(3.97)	4.73	(0.2)
Net Interest Margin (%)	1.83	1.55	3.11	1.93	1.92	1.74
Capital-to-Assets	0.09	0.09	0.16	0.16	0.13	0.12
Debt-to-Capital	10.21	9.99	5.33	5.09	6.43	7.19

# Less than $50,000 net recovery.

EXHIBIT 3-E.2

FEDERAL INTERMEDIATE CREDIT BANKS
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE
Nonperforming Loans ($ millions)	767.6	1,201.0	251.5	94.3	502.5	405.4
Formally Restructured	234.1	0	27.3	0	310.3	0
Other Restructured & Reduced Rate	0	0	0	0	0	0
Other High Risk	526.2	1,173.5	221.9	90.4	158.4	394.7
Nonaccrual	7.3	27.5	2.3	3.9	33.8	10.7
Net Loan Chargeoffs ($ millions)	0	0.4	0	#	0	0
Selected Ratios						
Return on Assets (%)	(1.18)	(8.83)	(2.99)	0.51	0.63	0.79
Return on Equity (%)	(11.99)	(87.88)	(20.46)	5.55	8.50	9.09
Net Interest Margin (%)	1.88	2.86	2.49	1.44	1.53	2.23
Capital-to-Assets	0.10	0.09	0.15	0.09	0.07	0.09
Debt-to-Capital	9.23	9.92	5.85	10.08	12.46	9.60

Less than $50,000 net recovery

Exhibit 5-C.1
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loans to Cooperatives: Seasonal Loans	$120,729	$91,617	$ 39,739	$142,811	$159,258	$162,446
Term	259,643	97,472	399,037	521,227	755,847	277,215
Commodity	0	0	46,449	0	0	24,425
Acceptances	0	0	0	0	4,500	0
Subtotal	380,372	189,089	485,226	664,038	919,604	464,086
Less: Participations	229,308	124,025	249,203	239,516	620,135	101,743
Less: Acceptances Discounted to Other FC Banks	0	0	0	0	0	0
Less: Unapplied Loan Payments	0	0	0	384	3,561	0
Less: Unearned Income (Acceptances)	0	0	0	0	32	0
Total Loans to Cooperative Associations	151,064	65,064	236,022	424,138	295,876	362,344
Nonaccrual Loans	629	1,648	18,082	1,239	2,359	2,206
Sales Contracts, Notes, Etc.	39	87	13,612	0	0	2,860
Accrued Interest Receivable on Loans	3,751	-1,046	-1,487	-1,210	6,636	7,549
Gross Loan Items	155,484	65,751	266,228	424,166	304,872	374,959
Less: Allowance for Losses	2,022	1,900	4,938	7,711	4,837	10,137
Net Loan Items	153,461	63,851	261,290	416,456	300,035	364,821
Cash	223	-149	279	1,146	4,993	1,974
Investments: U.S. Government Securities (Par)	0	0	0	0	1,000	0
Securities Government Supervised Institutions (Par)	0	0	0	10,000	3,000	4,000
Other Securities and Federal Funds	14,000	19,893	14,400	53,799	22,404	61,966
Unamortized Premium or Discount (Net)	0	0	0	89	-16	-22
Total Investment in Securities	14,000	19,893	14,400	63,888	26,388	65,942
Investments in Central Bank for Cooperatives	19,870	8,313	24,208	24,837	43,746	16,999
Investments in Other Banks for Cooperatives	244	0	578	0	0	0
Investments in DBC Bankers Acceptances (Net)	0	0	0	0	0	0
Notes Receivable Farm Credit Banks and Other	2,895	5,116	675	9	30,000	5,957
Accounts Receivable	4,406	1,072	319	245	899	1,861
Accrued Interest Receivable - Other Farm Credit Banks	11	29	4	1	355	0
Accrued Interest Receviable - Investments	36	543	56	983	418	452
Acquired Property	0	0	0	0	0	86
Less: Accumulated Depreciation	0	0	0	0	0	0
Less: Allowance for Losses	0	0	0	0	0	0
Net Acquired Property	0	0	0	0	0	86
Land, Buildings, and Equipment	1,135	0	430	3,122	6,969	5,215
Less: Accumulated Depreciation	234	0	253	902	576	889
Net Land, Buildings, and Equipment	901	0	177	2,220	6,394	4,326
Customers Liability on Acceptances Outstanding	0	0	0	0	0	0
Prepaid Expenses and other Assets	282	522	5,498	2,033	1,843	1,020
Total Assets	$196,330	$99,189	$307,483	$511,818	$415,072	$463,440

Exhibit 5-C.2
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Notes Payable: Other Farm Credit Banks	$ 0	$ 0	$ 4,078	$ 4,000	$ 7,555	$ 0
Consolidated Systemwide Notes	49,755	19,858	64,718	27,745	82,069	41,578
Commercial banks and Other	0	571	0	0	2,165	3,339
Securities Sold Under Agreement to Repurchase	0	0	0	10,200	0	0
Total Notes Payable	49,755	20,429	68,796	41,945	91,789	44,917
Accounts Payable	2,737	318	3,600	3,643	387	1,326
Accrued Interest Payable	2,533	1,451	4,829	10,180	5,586	8,168
Unmatured Consolidated and Systemwide Bonds	88,010	53,962	175,480	321,850	169,000	307,000
Less: Consolidated Bonds Owned	0	0	10,000	0	0	0
Net Consolidated and System Bonds Outstanding	88,010	53,962	165,480	321,850	169,000	307,000
Unmatured Farm Credit Investment Bonds Outstanding	0	3,233	2,120	32,751	25,640	6,050
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0
Capital Stock and Equities Called For Retirement	0	0	0	0	0	0
Bankers Liability on Acceptances Outstanding	0	0	0	0	0	0
Other Liabilities	194	45	588	343	234	47
Total Liabilities	143,230	79,438	245,413	410,712	292,635	367,510
Capital Stock: Class B - All	0	0	0	0	0	0
Class C - District Banks	0	239	95	52	179	624
Class C - Cooperative Associations	34,964	13,327	39,560	68,041	94,758	62,611
Class D - All	0	0	0	0	0	0
Other - Cooperative Associations	0	0	0	0	0	0
Class C - Subscribed - Cooperative Associations	3,132	0	3,772	255	204	3,211
Class C - Subscribed - District Banks	0	0	0	0	0	56
Total Capital Stock	38,096	13,566	43,426	68,348	95,141	66,503
Earned Net Worth: Surplus Reserved	4,419	2,576	4,371	5,180	3,628	6,154
Surplus Allocated to Cooperative Associations	9,090	190	8,779	22,584	19,694	16,746
Surplus Allocated to District Banks	0	5	18	21	49	175
Surplus Unallocated	644	2,756	3,964	691	1,912	2,731
Undistributed Earnings	851	659	1,512	4,282	2,013	3,621
Total Earned Net Worth	15,004	6,185	18,644	32,759	27,295	29,428
Total Net Worth	53,100	19,751	62,070	101,107	122,437	95,930
Total Liabilities and Net Worth	$196,330	$99,189	$307,483	$511,818	$415,072	$463,440

Exhibit 5-C.3
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane	Central
Loans to Cooperatives: Seasonal Loans	$ 299,911	$128,714	$152,966	$ 31,208	$589,382	$219,812	$1,411,340
Term	1,116,787	313,113	322,612	123,162	182,997	202,422	1,813,601
Commodity	17,686	3,000	54,700	3,100	12,281	0	9,978
Acceptances	32,000	0	4,433	2,000	0	0	71,323
Subtotal	1,466,384	444,827	534,711	159,470	784,659	422,234	3,306,243
Less: Participations	485,104	29,826	108,414	20,703	311,400	105,160	59,210
Less: Acceptances Discounted to Other FC Banks	0	0	0	0	0	0	0
Less: Unapplied Loan Payments	0	1,156	1,644	0	211	0	0
Less: Unearned Income (Acceptances)	146	23	114	0	0	0	794
Total Loans to Cooperative Associations	981,134	413,822	424,539	138,767	473,049	317,074	3,246,239
Nonaccrual Loans	4,261	5,777	1,580	5,393	32,457	1,960	52,885
Sales Contracts, Notes, Etc.	10,035	159	174	382	34,973	369	28,750
Accrued Interest Receivable on Loans	27,891	12,669	10,903	3,948	7,553	7,286	69,108
Gross Loan Items	1,023,321	432,428	437,196	148,490	548,033	326,689	3,396,982
Less! Allowance for Losses	18,708	5,538	4,724	2,266	15,589	5,004	39,007
Net Loan Items	1,004,613	426,890	432,472	146,224	532,443	321,685	3,357,975
Cash	5,070	1,122	2,415	1,013	1,045	397	376
Investments: U.S. Government Securities (Par)	0	5,000	0	0	0	800	0
Securities Government Supervised Institutions (Par)	0	11,000	0	0	450	13,500	4
Other Securities and Federal Funds	130,147	69,938	51,701	81,088	4,174	33,956	897,375
Unamortized Premium or Discount (Net)	-1,157	-12	-172	-184	0	-632	-1,516
Total Investment in Securities	128,989	85,925	51,528	80,903	4,624	47,623	895,862
Investments in Central Bank for Cooperatives	69,140	5,350	21,455	5,058	21,194	10,706	0
Investments in Other Banks for Cooperatives	2,683	0	7,861	316	0	0	0
Investments in DBC Bankers Acceptances (Net)	0	0	0	0	0	0	0
Notes Receivable Farm Credit Banks and Other	28,295	10,856	1,999	586	34,729	3,249	13,559
Accounts Receivable	5,243	926	2,902	383	4,549	978	670
Accrued Interest Receivable - Other Farm Credit Banks	790	104	39	19	56	9	243
Accrued Interest Receviable - Investments	1,227	1,632	45	352	34	80	2,042
Acquired Property	647	542	734	2,359	683	372	1,254
Less: Accumulated Depreciation	0	0	0	0	0	87	0
Less: Allowance for Losses	0	166	0	0	0	97	0
Net Acquired Property	647	376	734	2,359	683	188	1,254
Land, Buildings, and Equipment	6,046	2,612	2,021	10,006	4,826	8,443	2,015
Less: Accumulated Depreciation	1,418	1,003	531	432	1,046	851	1,006
Net Land, Buildings, and Equipment	4,627	1,609	1,490	9,573	3,779	7,592	1,009
Customers Liability on Acceptances Outstanding	0	0	0	0	0	0	0
Prepaid Expenses and other Assets	6,850	1,445	1,424	812	640	1,414	6,722
Total Assets	$1,258,175	$536,234	$524,364	$247,597	$603,776	$393,922	$4,279,714

Exhibit 6-A.1

TRENDS IN CONDITION AND INCOME

	Federal Land Banks Summary of Condition				
	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Loans - total principal	52,261.5	52,103.9	51,056.4	49,254.9	
Performing	48,276.7	46,769.4	45,614.3	43,156.5	
Restructured	6.2	8.1	8.3	10.3	
Other restructured & reduced rate	9.0	42.8	9.8	17.1	
Other high risk	2,853.8	3,980.5	3,570.1	2,773.7	
Nonaccrual	1,115.8	1,303.1	1,853.9	3,297.3	
Less: Allowance for losses	547.1	529.2	512.7	915.6	
Net loans	51,714.4	51,574.7	50,543.7	48,339.3	
Cash & investments in securities	1,260.3	1,316.9	1,388.3	2,041.4	
Net acquired property	313.8	400.2	568.9	674.7	
Other assets net of adjustments	2,159.8	1,327.9	1,709.8	2,224.6	
Total assets	55,448.3	54,619.7	54,210.7	53,280.0	
Total liabilities	49,411.1	48,525.7	48,182.2	47,920.3	
Capital stock & participation certificates	2,854.1	2,841.1	2,772.8	2,671.1	
Earned net worth	3,183.0	3,252.9	3,255.7	2,688.5	
Total net worth	6,037.1	6,094.0	6,028.5	5,359.6	

Components may not add to exact totals due to rounding.

Exhibit 6-A.2
Federal Land Banks
Trends in Income and Expenses

	9 months ending					
	09-30-84	09 -30-85	03-31-85	06-30-85	09-30-85	12-31-85
Total Interest Income	4,671.2	4,509.5	1,546.7	1,526.8	1,435.9	—
Less: Total Interest Expense	4,323.0	4,096.4	1,392.9	1,364.4	1,339.1	—
Net Interest Income	348.2	413.1	153.8	162.4	96.8	—
Less: Provision for Loan Losses	20.1	612.0	22.8	79.9	509.8	—
Net Interest Income after Provision	328.1	(198.9)	131.0	82.5	(412.5)	—
Plus: Other Income	50.7	13.5	8.2	4.5	3.2	—
Less: Other Expenses	189.0	301.9	69.3	84.2	150.8	—
Net Income	189.8	(487.3)	69.9	2.8	(560.1)	—

Exhibit 6-A.3
Federal Land Banks
Trends in Selected Financial Measures

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Return on assets (%)	0.34	0.51	0.02	(4.17)	—
Return on equity (%)	3.08	4.61	0.19	(39.35)	—
Net interest margin (%)	0.89	1.18	1.26	0.75	—
Net chargeoffs on loans ($ millions)	90.4	40.7	98.3	140.3	—
Capital-to-assets ratio	0.11	0.11	0.11	0.10	—
Debt-to-capital ratio	8.18	7.96	7.99	8.94	—

Source: Reports of financial condition and performance.
Components may not sum to totals due to rouning.

Exhibit 6-B.1
Federal Intermediate Credit Banks
Summary of Condition

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Loans - total principal	17,274.3	16,012.0	16,202.5	15,733.2	
Performing	14,827.3	13,215.7	12,373.4	11,749.6	
Restructured	31.1	35.1	38.5	612.5	
Other restructured & reduced rate	—	260.5	299.5	0	
Other high risk	2,135.0	2,253.9	3,362.3	3,266.4	
Nonaccrual	280.9	246.8	128.8	104.7	
Less: Allowance for losses	29.3	32.1	34.2	51.0	
Net loans	17,245.0	15,979.9	16,168.3	15,682.2	
Cash & investments in securities	1,328.1	1,254.4	1,296.9	1,733.0	
Net acquired property	3.5	3.0	4.6	13.2	
Other assets net of adjustments	784.6	687.1	691.3	603.9	
Total assets	19,361.2	17,924.4	18,161.1	18,032.3	
Total liabilities	17,362.6	15,894.3	16,144.7	16,056.6	
Capital stock & participation certificates	1,425.4	1,424.4	1,416.5	1,412.6	
Earned net worth	573.2	605.6	599.9	563.0	
Total net worth	1,998.6	2,030.0	2,016.4	1,975.7	

Components may not add to exact totals due to rounding.

Exhibit 6-B.2
Federal Intermediate Credit Banks
Trends in of Income and Expenses

	9 months ending					
	09-30-84	09-30-85	03-31-85	06-30-85	09-30-85	12-31-85
Total Interest Income	1,603.9	1,382.1	481.0	448.7	452.4	—
Less: Total Interest Expense	1,410.5	1,164.7	420.7	379.9	364.1	—
Net Interest Income	193.4	217.4	60.3	68.8	88.3	—
Less: Provision for Loan Losses	2.0	51.4	4.1	22.9	24.4	—
Net Interest Income after Provision	191.4	166.0	56.2	45.9	63.9	—
Plus: Other Income	0.5	76.6	0.6	(0.1)	76.4	
Less: Other Expenses	67.9	242.0	24.0	38.6	179.7	—
Net Income	124.0	0.6	32.8	7.2	(39.4)	—

Exhibit 6-B.3
Federal Intermediate Credit Banks
Trends in Selected Financial Measures

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Return on assets (%)	0.62	0.70	0.02	(0.87)	—
Return on equity (%)	6.17	6.52	0.19	(7.89)	—
Net interest margin (%)	1.38	1.37	1.26	2.03	—
Net chargeoffs on loans ($ millions)	21.9	1.2	98.3	1.3	—
Capital-to-assets ratio	0.10	0.11	0.11	0.11	—
Debt-to-capital ratio	8.69	7.83	7.99	8.13	—

Exhibit 5-C.4
Banks for Cooperatives
Statement of Condition
September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane	Central
Notes Payable: Other Farm Credit Banks	$ 8,913	$ 0	$ 11,500	$ 0	$ 0	0	$ 287,379
Consolidated Systemwide Notes	175,394	976	111,627	65,564	277,110	149,602	2,369,852
Commercial Banks and Other	8,710	0	0	1,234	4,204	2,448	1,798
Securities Sold Under Agreement to Repurchase	0	14,868	0	0	0	0	0
Total Notes Payable	193,016	15,844	123,127	66,798	281,314	152,050	2,659,029
Accounts Payable	4,027	6,581	3,999	27	1,485	409	7,951
Accrued Interest Payable	27,047	13,517	5,918	3,435	4,550	6,447	34,738
Unmatured Consolidated and Systemwide Bonds	788,610	412,250	215,114	97,001	190,000	177,000	1,253,605
Less: Consolidated Bonds Owned	0	25,000	0	0	0	0	0
Net Consolidated and System Bonds Outstanding	788,610	387,250	215,114	97,001	190,000	177,000	1,253,605
Unmatured Farm Credit Investment Bonds Outstanding	7,175	11,605	25,398	32,521	0	1,630	0
Matured Farm Credit Investment Bonds Outstanding	0	0	0	0	0	0	0
Capital Stock and Equities Called For Retirement	0	0	0	5	0	1,769	0
Bankers Liability on Acceptances Outstanding	0	0	0	0	0	0	0
Other Liabilities	2,347	1,349	841	309	597	171	2,494
Total Liabilities	1,022,222	436,145	374,396	200,096	477,946	339,476	3,957,817
Capital Stock: Class B - All	0	0	0	0	475	0	0
Class C - District Banks	1,117	6,361	230	389	0	554	229,515
Class C - Cooperative Associations	158,621	69,032	101,861	26,492	85,056	38,440	0
Class D - All	1,127	0	0	0	0	0	0
Other - Cooperative Associations	0	0	1,530	0	0	0	0
Class C - Subscribed - Cooperative Associations	11,677	2,768	4,230	381	5,510	1,342	0
Class C - Subscribed - District Banks	37	189	0	11	0	0	0
Total Capital Stock	172,578	78,350	107,851	27,274	91,040	40,336	229,515
Earned Net Worth: Surplus Reserved	6,638	2,423	6,336	5,038	6,658	5,014	29,676
Surplus Allocated to Cooperative Associations	50,743	13,891	23,584	4,415	21,235	7,859	0
Surplus Allocated to District Banks	322	746	48	71	0	117	32,210
Surplus Unallocated	5,670	3,717	4,511	9,852	1,359	1,375	8,681
Undistributed Earnings	0	962	7,637	853	5,538	-254	21,815
Total Earned Net Worth	63,374	21,739	42,116	20,228	34,789	14,109	92,382
Total Net Worth	235,953	100,089	149,967	47,502	125,830	54,445	321,897
Total Liabilities and Net Worth	$1,258,175	$536,234	$524,364	$247,597	$603,776	$393,922	$4,279,714

Exhibit 5-D.1
Banks for Cooperatives
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	Springfield	Baltimore	Columbia	Louisville	Jackson	St. Louis
Loan Interest Income: Cooperative Associations	$3,809	$1,539	$6,385	$11,842	$7,776	$9,960
Sales Contracts	1	68	416	0	0	0
Notes Receivable Other Farm Credit Banks	43	65	6	11	227	0
Other Interest Income	0	0	0	0	357	65
Total Interest Income from Loans	3,854	1,673	6,807	11,853	8,360	10,025
Income from Investments (Net)	317	409	589	1,518	751	1,236
Compensation Income - Participations Sold	2	0	0	0	0	0
Appraisal and Loan Service Fees	0	0	0	0	0	3
Financially Relate Services	0	0	0	0	0	12
Customers Draft Accepted Fees	0	0	0	0	0	0
Letters of Credit Issued Fees	46	0	36	1	126	0
Income from Distribution of Earnings of Central BC	2,215	366	0	0	0	258
Income from Dist. of Earnings of Other District Banks	0	0	0	0	0	0
Gross Earnings	6,433	2,448	7,433	13,372	9,237	11,534
Notes and Bonds Expense: Cost of Bonds	2,338	1,389	4,846	9,429	5,838	8,490
Interest on Notes Payable	780	374	1,604	1,002	1,286	351
Total Cost of Borrowed Funds	3,119	1,763	6,449	10,431	7,124	8,841
Compensation Expense - Participations Purchased	0	2	0	0	0	0
Operating Expense	480	334	717	1,375	1,140	941
Total Expenses	3,599	2,098	7,166	11,805	8,263	9,782
Net Gain (Loss) from Operations	2,834	350	266	1,567	974	1,752
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	-126	0	0
Income (Expense) Acquired Property	0	0	0	0	0	0
Gain (Loss) - Disposition of Acquired Property	0	0	0	0	0	0
Provision for Losses - Acquired Property	0	0	0	0	0	0
Income (Expense) Office Building or Premises	0	0	0	0	0	0
Income (Expense) Land/Buildings (Investment)	0	0	0	0	-7	0
Other Gains (Losses)	-403	-185	-39	-1,180	-925	-583
Other Income (Expense)	21	0	15	3	0	0
Total Other Additions and Deductions	-381	-185	-24	-1,304	-933	-583
Net Gain (Loss) Before Provision for Losses	2,452	163	242	262	39	1,168
Provision for Losses	0	-249	-239	-149	-249	-149
Net Earnings before Income Taxes	2,452	-86	2	112	-210	1,018
Less: Federal and Other Income Taxes	0	-3	75	0	0	91
Net Earnings	$2,452	$ -82	$ -72	$ 112	$ -210	$ 927

Exhibit 5-D.2

Banks for Cooperatives
Statement of Income
Three Months Ending September 30, 1985
($000 Omitted)

	St. Paul	Omaha	Wichita	Texas	Sacramento	Spokane	Central
Loan Interest Income: Cooperative Associations	$27,736	$12,693	$10,811	$4,147	$12,946	$8,440	$78,846
Sales Contracts	189	5	0	13	841	10	737
Notes Receivable Other Farm Credit Banks	404	107	71	1	81	39	489
Other Interest Income	787	3	55	-12	0	0	7
Total Interest Income from Loans	29,116	12,808	10,937	4,147	13,868	8,489	80,079
Income from Investments (Net)	2,457	1,958	799	1,650	78	898	19,273
Compensation Income - Participations Sold	0	0	0	0	0	0	0
Appraisal and Loan Service Fees	0	0	0	0	0	0	0
Financially Related Services	0	0	12	0	0	0	0
Customers Draft Accepted Fees	0	0	0	0	0	0	0
Letters of Credit Issued Fees	64	12	8	19	1	1	659
Income from Distribution of Earnings of Central BC	2,364	401	337	213	800	255	0
Income from Dist. of Earnings of Other District Banks	0	0	0	0	0	0	0
Gross Earnings	34,001	15,179	12,093	6,029	14,748	9,644	100,011
Notes and Bonds Expense: Cost of Bonds	21,962	11,444	6,331	3,368	5,294	5,782	36,687
Interest on Notes Payable	3,634	412	1,725	1,226	5,950	2,154	52,217
Total Cost of Borrowed Funds	25,595	11,857	8,056	4,594	11,244	7,936	88,903
Compensation Expense - Participations Purchased	0	0	0	0	0	0	0
Operating Expense	2,051	1,411	1,811	867	875	885	3,531
Total Expenses	27,646	13,268	9,867	5,461	12,119	8,821	92,434
Net Gain (Loss) from Operations	6,355	1,911	2,227	568	2,628	823	7,577
Other Add/Deduct: Gain (Loss) - Sale of Investment	0	0	0	0	0	0	0
Income (Expense) Acquired Property	-14	-1	0	-4	0	32	0
Gain (Loss) - Disposition of Acquired Property	0	0	0	0	0	0	0
Provision for Losses - Acquired Property	0	0	0	0	0	0	0
Income (Expense) Office Building or Premises	0	0	0	0	0	-27	130
Income (Expense) Land/Buildings (Investment)	0	2	0	0	0	3	0
Other Gains (Losses)	-1,797	-1,792	-665	-263	-1,154	-472	-275
Other Income (Expense)	11	-4	3	5	1	0	7
Total Other Additions and Deductions	-1,800	-1,797	-663	-263	-1,154	-464	-138
Net Gain (Loss) Before Provision for Losses	4,553	113	1,563	303	1,473	358	7,438
Provision for Losses	-299	-2,154	-194	-224	-1,149	-176	0
Net Earnings before Income TAXES	4,253	-2,041	1,368	78	323	182	7,438
Less: Federal and Other Income Taxes	189	74	0	0	0	25	99
Net Earnings	$ 4,064	$-2,115	$ 1,369	$ 78	$ 323	$ 157	$ 7,339

EXHIBIT 5-E.1

BANKS FOR COOPERATIVES
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	SPRINGFIELD	BALTIMORE	COLUMBIA	LOUISVILLE	JACKSON	ST. LOUIS
Nonperforming Loans ($ millions)	0.6	5.3	60.5	2.6	2.9	34.7
Formally Restructured	0	0.1	0	0	0	0
Other Restructured & Reduced Rate	0	0	0	0	0	0
Other High Risk	a	3.6	42.5	1.4	0.5	32.5
Nonaccrual	0.6	1.6	18.0	1.2	2.4	2.2
Net Chargeoffs ($ millions)	0	0	2.0	0	0.1	(0.5)
Selected Ratios						
Return on Assets (%)	5.05	(0.33)	(0.09)	0.8	(0.20)	0.77
Return on Equity (%)	18.63	(1.60)	(0.47)	0.42	(0.69)	3.84
Net Interest Margin (%)	2.51	1.40	1.27	2.27	2.21	2.13
Capital-to-Assets	0.27	0.20	0.20	0.20	0.29	0.21
Debt-to-Capital	2.70	4.02	3.95	4.06	2.39	3.83

a Indicates less than $50,000
* Indicates net loan chargeoff less than $50,000

EXHIBIT 5-E.2

BANKS FOR COOPERATIVES
NONPERFORMING LOANS, CHARGEOFFS, AND FINANCIAL RATIOS
SEPTEMBER 30, 1985

	ST. PAUL	OMAHA	WICHITA	TEXAS	SACRAMENTO	SPOKANE	CENTRAL
Nonperforming Loans ($ millions)	66.8	90.2	10.6	23.7	78.9	35.0	140.5
Formally Restructured	0	0	0	8.4	0	0	5.9
Other Restructured & Reduced Rate	0	0.3	0	1.0	46.4	0	0
Other High Risk	62.5	84.1	9.0	8.9	0	33.0	81.7
Nonaccural	4.3	5.8	1.6	5.4	32.5	2.0	52.9
Net Loan Chargeoffs ($ millions)	0.1	1.2	*	0.1	3.0	0.1	5.0
Selected Ratios							
Return on Assets (%)	1.24	(1.39)	1.06	0.12	0.20	0.16	0.68
Return on Equity (%)	6.99	(8.34)	3.55	0.66	1.03	1.55	9.20
Net Interest Margin (%)	1.99	2.00	3.14	2.07	1.81	1.58	0.98
Capital-to-Assets	0.19	0.19	0.29	0.19	0.21	0.14	0.08
Debt-to-Capital	4.33	4.36	2.50	4.21	3.80	6.24	12.30

a Indicates less than $50,000
* Indicates net loan chargeoff less than $50,000

Exhibit 6-C.1
Banks for Cooperatives
Summary of Condition

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Loans - total principal	9,014.0	9,168.1	8,343.2	7,751.1	
Performing	8,476.2	8,553.1	7,793.2	7,199.0	
Restructured	44.8	36.0	39.6	14.4	
Other restructured & reduced rate	0.3	0.2	0.0	47.6	
Other high risk	478.1	564.9	480.2	359.6	
Nonaccrual	14.6	13.9	30.2	130.5	
Less: Allowance for losses	121.2	124.6	128.2	122.4	
Net loans	8,892.8	9,043.5	8,215.0	7,628.7	
Cash & investments in securities	843.5	908.1	1,516.0	1,519.9	
Net acquired property	3.9	3.9	6.3	6.3	
Other assets net of adjustments	334.3	309.0	332.7	280.4	
Total assets	10,074.5	10,264.5	10,069.5	9,435.3	
Total liabilities	8,867.9	9,061.0	8,850.2	8,227.8	
Capital stock & participation certificates	861.3	835.4	843.5	832.4	
Earned net worth	345.3	368.1	375.9	375.1	
Total net worth	1,206.6	1,203.5	1,219.4	1,207.5	

Components may not add to exact totals due to rounding.

Exhibit 6-C.2
Banks for Cooperatives
Trends in of Income and Expenses

	9 months ending					
	09-30-84	09-30-85	03-31-85	06-30-85	09-30-85	12-31-85
Total Interest Income	892.8	759.2	266.7	260.1	232.4	—
Less: Total Interest Expense	740.9	628.4	220.3	213.7	194.4	—
Net Interest Income	151.9	130.8	46.4	46.4	38.0	—
Less: Provision for Loan Losses	11.3	12.5	3.4	3.8	5.2	—
Net Interest Income after Provision	140.6	118.3	43.0	42.6	32.8	—
Plus: Other Income	3.4	2.9	0.9	1.0	1.0	—
Less: Other Expenses	44.8	60.3	16.0	17.7	26.5	—
Net Income	99.0	60.9	27.9	25.9	7.1	—

Exhibit 6-C.3
Banks for Cooperatives
Trends in Selected Financial Measures

	12-31-84	03-31-85	06-30-85	09-30-85	12-31-85
Return on assets (%)	1.29	1.10	1.02	0.29	—
Return on equity (%)	11.09	9.25	8.55	2.35	—
Net interest margin (%)	1.99	1.85	1.84	1.58	—
Net chargeoffs on loans ($ millions)	10.1	*	0.2	11.1	—
Capital-to-assets ratio	0.12	0.12	0.12	0.13	—
Debt-to-capital ratio	7.35	7.53	7.26	6.81	—

Source: Reports of financial condition and performance.
Components may not sum to totals due to rouning.

* Indicates less then $50,000.

Appendix B

Percentage distribution of commercial farm operators and their assets and debt, by financial position

January 1985

Financial position	Operators	Assets	Total debt	Debt owed to-- Banks	Farm Credit System	Farmers Home Adm.
Good.........	70	65	51	47	53	39
Fair.........	13	18	16	15	15	18
Stressed.....	7	7	10	13	12	12
Vulnerable...	10	10	23	25	20	31
Total.....	100	100	100	100	100	100

Data for 634,000 "commercial" farms with sales of $40,000 or more in 1984, from the 1984 Farm Costs and Returns Survey, ERS, USDA. Dr. Emanuel Melichar, Farm Economist, Federal Reserve, October 23, 1985, testimony before the subcommittee on economic stailization of the House Banking, Financial, and Urban Affairs Committee, page 11.

[The following letter from Mr. Wilkinson is in answer to questions from Senators at the October 31 hearing:]

Farm Credit Administration,
McLean, VA, November 20, 1985.

Honorable Jesse A. Helms
Chairman, Committee on Agriculture, Nutrition, and Forestry
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

This responds to six questions asked of the Farm Credit Administration (FCA) on October 31, 1985, during hearing conducted by the Committee on Agriculture, Nutrition, and Forestry.

1. Senator Boschwitz asked for the cash position, anticipated cash-flows, and debt maturity schedule of the banks and associations of the Farm Credit System (System).

FCA response: As the regulatory agency supervising the banks and associations of the System, FCA does not manage the System's cash, investments, or debt issues. FCA supervises the System from a safety-and-soundness standpoint with emphasis on compliance with the Farm Credit Act of 1971, as amended.

As do other lenders, the banks and associations of the System manage their own financial affairs, for which they are accountable. In addition, the 37 Farm Credit banks own the Federal Farm Credit Banks Funding Corporation, which maintains a central liquidity fund for the banks' use.

Enclosed is the information requested by Senator Boschwitz on System cash, investment, and debt. Because this information was gathered from several different sources, certain amounts differ from FCA-published reports on the financial condition of the System.

2. Senator Exon requested the salaries for the top 15 officers in the Omaha District for the past 3 years.

FCA response: This information has been furnished to the Committee by the Farm Credit Banks of Omaha.

3. Senator Pryor asked for the number of foreclosures by state where a borrower was not in arrears.

FCA response: The number of foreclosures by Farm Credit district for Federal lank banks is enclosed. The FCA does not maintain foreclosure information by state. Foreclosures by production credit associations is not available at this time.

FCA has no information on the number of foreclosures that may have occurred where a borrower was not in arrears on his loan payment, but may have been in violation of a loan covenant, or may have defaulted on a second or third mortgage.

4. Senator Boren asked about the Wichita District's authority to punish associations that don't approve mergers.

FCA response: The Wichita District does not have the authority to "punish" any association that doesn't approve a merger plan. Proposed mergers are voted on by all shareholders of record, after each has received an FCA-mandated disclosure statement.

5. Senator Grassley asked that local associations be notified of the Wichita District board's error in stating that associations would be punished if they failed to approve the proposed merger.

FCA response: The FCA has directed the president of the Farm Credit Banks of Wichita to contact each association and clarify any misunderstanding that may have arisen about the district bank's role in the merger vote.

6. You asked for FCA's recommendations and alternatives for restructuring the present Federal Farm Credit Board.

FCA response: The FCA has set forth its recommendations for a restructured Federal Farm Credit Board (Board) in a separate letter to you of November 8, 1985. In essence, the FCA believes that a part-time Board should be maintained, although with fewer members serving under more clearly defined jurisdiction. Such members would not have to come from the System, would serve nonrenewable 6-year terms, and would possess either demonstrated financial expertise or have a meaningful understanding of agriculture.

FCA believes that the Board should be continued, with substantial modifications, as a policymaking body within the FCA.

We hope this information responds to the questions asked of FCA by you and members of the committee. Please let us know it we can be of further service to you.

Sincerely,

Donald E. Wilkinson, Governor.

Enclosures.

(ATTACHMENT 1)

Farm Credit Banks
Schedule of Cash Balances
as of September 30, 1985
($000 omitted)

	FLB	FICB	BC	Total
Springfield	2,791	2,556	223	5,570
Baltimore	4,107	2,075	(149)	6,033
Columbia	223	285	279	787
Louisville	6,658	6,679	1,146	14,483
Jackson	5,600	456	4,993	11,049
St. Louis	5,220	8,996	1,974	16,190
St. Paul	8,593	11,968	5,070	25,631
Omaha	8,500	1,918	1,122	11,540
Wichita	1,787	3,257	2,415	7,459
Texas	3,692	2,137	1,013	6,842
Sacramento	965	14,095	1,045	16,105
Spokane	6,209	4,045	397	10,651
Central Bank	-	-	376	376
	54,345	58,467	19,904	132,716

This schedule includes cash balances maintained by the System's 37 banks. It excludes cash balances maintained by Production Credit Associations, Federal Land Bank Associations and the System's Special Funding Reserve.

~~Attachment #1~~

(ATTACHMENT 2)

FARM CREDIT BANKS
SUMMARY OF SHORT TERM INVESTMENT POSITION
AS OF SEPTEMBER 30, 1985

SHORT TERM INVESTMENTS
($MILLIONS)

MATURITY (DAYS)	FLB	FICB	BC	SFR	TOTAL
1-5	509.59	548.78	702.50	225.50	1986.37
6-15	127.30	65.50	190.60	78.80	462.20
16-30	174.00	90.00	210.60	147.50	622.10
31-45	85.10	54.40	177.00	56.10	372.60
TOTAL STI	895.99	758.68	1280.70	507.90	3443.27
46+ DAY	759.54	746.75	265.25	14.70	1786.24
TOTAL INVESTMENT	1655.53	1505.43	1545.95	522.60	5229.51
AVG MATURITY	27.05	26.93	17.81	14.53	23.03

MATURING DEBT
($MILLIONS)

MATURITY (DAYS)	FLB	FICB	BC	SFR	TOTAL
1-5	656.97	1755.18	535.88	112.90	3060.93
6-15	234.70	538.70	551.30	103.10	1427.80
16-30	1768.48	688.17	671.00	25.00	3152.65
31-45	673.72	1528.34	681.58	46.20	2929.84
TOTAL MATURING	3333.87	4510.39	2439.76	287.20	10571.22
AVG MATURITY	21.11	18.61	19.86	12.87	19.53

SHORT TERM INVESTMENTS/MATURING DEBT

MATURITY (DAYS)	FLB	FICB	BC	SFR	TOTAL
1-5	77.6%	31.3%	131.1%	199.7%	64.9%
6-15	54.2%	12.2%	34.6%	76.4%	32.4%
16-30	9.8%	13.1%	31.4%	590.0%	19.7%
31-45	12.6%	3.6%	26.0%	121.4%	12.7%
TOTAL STI/MATURING	26.9%	16.8%	52.5%	176.8%	32.6%
TOTAL INVESTMENT /MATURING	49.7%	33.4%	63.4%	182.0%	49.5%

(ATTACHMENT 3)

SHORT TERM INVESTMENT POSITION REPORT

BANK: SYSTEMWIDE

REPORT IN $ MILLIONS

MONTH-END
REPORT DATE: SEPTEMBER 30, 1985

ROUNDED TO THE NEAREST $0.1 MILLION
REPORT IN $ MILLIONS

INVESTMENTS

DAYS TO MATURITY	FED FUNDS	TREASURIES	AGENCIES	COMMERCIAL PAPER & BA's	OTHER STI	(1) TOTAL
1-5	1595.90	0.00	13.90	143.10	233.47	1986.37
6-15	273.00	0.00	59.00	74.90	55.30	462.20
16-30	297.00	0.00	3.50	314.70	6.90	622.10
31-45	249.10	0.00	8.00	115.50	0.00	372.60
TOTAL STI	2415.00	0.00	84.40	648.20	295.67	3443.27
46 OR MORE	585.40	174.73	218.80	660.70	146.61	1786.24
TOTAL INVESTMENTS	3000.40	174.73	303.20	1308.90	442.28	5229.51

MATURITY DEBT

DAYS TO MATURITY	BOND PRINCIPAL (PAR AMT)	BOND INTEREST DUE	DISCOUNT NOTES (PAR AMT)	(2) TOTAL	STI AS A % OF MATURING DEBT 1/2 * 100%
1-5	2067.00	151.33	842.60	3060.93	64.9%
6-15	0.00	0.00	1427.80	1427.80	32.4%
16-30	766.30	792.84	1603.51	3152.65	19.7%
31-45	1674.70	86.56	1168.58	2929.84	12.7%
	4508.00	1030.73	5042.49	10571.22	32.6%

(ATTACHMENT 4)

FARM CREDIT SYSTEM
DEBT MATURITY PATTERNS
BY DISTRICT

	MATURITY RANGES					
	DISC NOTES 0 - 1 YR	BONDS 0 - 1 YR	BONDS 1 - 3 YR	BONDS 3 - 6 YR	BONDS 6+ YR	TOTAL
SPRINGFIELD	$289,690.00	$695,203.00	$440,268.00	$182,648.00	$62,916.00	$1,670,725.00
BALTIMORE	$196,000.00	$1,018,106.00	$733,550.00	$532,800.00	$202,906.00	$2,683,362.00
COLUMBIA	$201,000.00	$2,262,928.00	$1,686,178.00	$1,596,206.00	$497,174.00	$6,243,486.00
LOUISVILLE	$143,725.00	$1,724,393.00	$1,720,376.00	$1,163,768.00	$843,475.00	$5,595.737.00
JACKSON	$187,000.00	$1,236,296.00	$1,022,800.00	$737,400.00	$347,800.00	$3,531,296.00
ST LOUIS	$418,275.00	$2,379,000.00	$1,838,600.00	$1,026,000.00	$385,400.00	$6,047,275.00
ST PAUL	$1,296,850.00	$3,408,732.00	$2,685,322.00	$1,935,133.00	$1,012,329.00	$10,338,366.00
OMAHA	$541,150.00	$2,473,521.00	$2,014,120.00	$1,480,748.00	$602,322.00	$7,111,861.00
WICHITA	$390,500.00	$1,838,847.00	$1,803,309.00	$1,207,756.00	$475,858.00	$5,716,270.00
TEXAS	$899,535.00	$1,130,630.00	$1,047,764.00	$737,271.00	$325,749.00	$4,140,949.00
SACRAMENTO	$1,297,540.00	$2,752,725.00	$1,648,400.00	$1,271,700.00	$507,050.00	$7,477,415.00
SPOKANE	$633,505.00	$1,312,195.00	$1,154,553.00	$930,020.00	$454,400.00	$4,484,673.00
CENTRAL BANK	$2,484,665.00	$618,031.00	$289,257.00	$345,807.00	$91,514.00	$3,829,274.00
TOTAL	$8,979,435.00	$22,850,607.00	$18,084,497.00	$13,147,257.00	$5,808,893.00	$68,870,689.00
% PORTFOLIO	13.04%	33.18%	26.26%	19.09%	8.43%	100.00%

FFCBFC INFORMATION SYSTEMS

FARM CREDIT SYSTEM
DEBT MATURITY PATTERNS
BY DISTRICT

SYSTEMWIDE PERCENTAGES

	DISC NOTES 0 - 1 YR	BONDS 0 - 1 YR	BONDS 1 - 3 YR	BONDS 3 - 6 YR	BONDS 6+ YR	TOTAL
SPRINGFIELD	0.42%	1.01%	0.64%	0.27%	0.09%	2.43%
BALTIMORE	0.28%	1.48%	1.07%	0.77%	0.29%	3.90%
COLUMBIA	0.29%	3.29%	2.45%	2.32%	0.72%	9.07%
LOUISVILLE	0.21%	2.50%	2.50%	1.69%	1.22%	8.12%
JACKSON	0.27%	1.80%	1.49%	1.07%	0.51%	5.13%
ST LOUIS	0.61%	3.45%	2.67%	1.49%	0.56%	8.78%
ST PAUL	1.88%	4.95%	3.90%	2.81%	1.47%	15.01%
OMAHA	0.79%	3.59%	2.92%	2.15%	0.87%	10.33%
WICHITA	0.57%	2.67%	2.62%	1.75%	0.69%	8.30%
TEXAS	1.31%	1.64%	1.52%	1.07%	0.47%	6.01%
SACRAMENTO	1.88%	4.00%	2.39%	1.85%	0.74%	10.86%
SPOKANE	0.92%	1.91%	1.68%	1.35%	0.66%	6.51%
CENTRAL BANK	3.61%	0.90%	0.42%	0.50%	0.13%	5.56%
TOTAL	13.04%	33.18%	26.26%	19.09%	8.43%	100.00%

FFCBFC INFORMATION SYSTEMS

SYSTEMWIDE FEDERAL LAND BANK TOTALS

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	2,877	028	088	001	027	001	39,195,571	537,738
RESTRUCTURED	1,307	009	000	000	453	004	8,047	060
OTHER RESTRUCT. OR REDUCED RATE	445	001	1,628	012	000	001	15,083	069
OTHER HIGH RISK	191,901	1,999	445,856	3,090	93,218	500	1,646,506	15,702
TOTAL	196,530	2,037	447,572	3,103	93,698	506	40,865,207	553,569
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	121,123	121
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	346	011
TOTAL	000	000	000	000	000	000	121,469	132
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	2,877	028	088	001	027	001	39,316,694	537,859
RESTRUCTURED	1,307	009	000	000	453	004	8,047	060
OTHER RESTRUCT. OR REDUCED RATE	445	001	1,628	012	000	001	15,083	069
OTHER HIGH RISK	191,901	1,999	445,856	3,090	93,218	500	1,646,852	15,713
NONACCRUAL	155,873	437	718,712	3,089	206,278	565	1,365,373	3,531
TOTAL	352,403	2,474	1,166,284	6,192	299,976	1,071	42,352,049	557,232
PERCENTS-COMBINED AMTS								
PERFORMING	00.8	01.1	00.0	00.0	00.0	00.1	92.8	96.5
RESTRUCTURED	00.4	00.4	00.0	00.0	00.2	00.4	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.1	00.0	00.1	00.2	00.0	00.1	00.0	00.0
OTHER HIGH RISK	54.5	80.8	38.2	49.9	31.1	46.7	03.9	02.8
NONACCRUAL	44.2	17.7	61.6	49.9	68.8	52.8	03.2	00.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	1,855	019	000	000	000	000	955,412	16,981
RESTRUCTURED	000	000	000	000	000	000	018	001
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	1,527	020	10,301	113	106	001	13,233	110
TOTAL	3,382	039	10,301	113	106	001	968,663	17,092
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	5,087	001
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	5,087	001
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	1,855	019	000	000	000	000	960,499	16,982
RESTRUCTURED	000	000	000	000	000	000	018	001
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	1,527	020	10,301	113	106	001	13,233	110
NONACCRUAL	415	003	4,521	028	2,876	036	372	009
TOTAL	3,797	042	14,822	141	2,982	037	974,122	17,102
PERCENTS-COMBINED AMTS								
PERFORMING	48.9	45.2	00.0	00.0	00.0	00.0	98.6	99.3
RESTRUCTURED	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	40.2	47.6	69.5	80.1	03.6	02.7	01.4	00.6
NONACCRUAL	10.9	07.1	30.5	19.9	96.4	97.3	00.0	00.1
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	2,087,040	39,078
RESTRUCTURED	066	002	000	000	220	002	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	215	003	000	001	081	003
OTHER HIGH RISK	5,186	062	12,007	155	1,520	022	38,495	534
TOTAL	5,252	064	12,222	158	1,740	025	2,125,616	39,615
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	1,104	010
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	1,104	010
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	2,088,144	39,088
RESTRUCTURED	066	002	000	000	220	002	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	215	003	000	001	081	003
OTHER HIGH RISK	5,186	062	12,007	155	1,520	022	38,495	534
NONACCRUAL	3,702	016	4,707	045	2,785	022	14,258	029
TOTAL	8,954	080	16,929	203	4,525	047	2,140,978	39,654
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	97.5	98.6
RESTRUCTURED	00.7	02.5	00.0	00.0	04.9	04.3	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	01.3	01.5	00.0	02.1	00.0	00.0
OTHER HIGH RISK	57.9	77.5	70.9	76.4	33.6	46.8	01.8	01.3
NONACCRUAL	41.3	20.0	27.8	22.2	61.5	46.8	00.7	00.1
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	4,892,498	87,374
RESTRUCTURED	022	001	000	000	000	000	1,079	005
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	29,342	394	47,122	367	6,331	035	173,087	2,022
TOTAL	29,364	395	47,122	367	6,331	035	5,066,664	89,401
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	277	005
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	277	005
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	4,892,775	87,379
RESTRUCTURED	022	001	000	000	000	000	1,079	005
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	29,342	394	47,122	367	6,331	035	173,087	2,022
NONACCRUAL	986	006	50,847	217	759	006	78,067	201
TOTAL	30,350	401	97,969	584	7,090	041	5,145,008	89,607
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	95.1	97.5
RESTRUCTURED	00.1	00.2	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	96.7	98.3	48.1	62.8	89.3	85.4	03.4	02.3
NONACCRUAL	03.2	01.5	51.9	37.2	10.7	14.6	01.5	00.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	3,828,827	58,262
RESTRUCTURED	000	000	000	000	000	000	719	004
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	12,469	179	11,262	114	3,891	039	204,819	1,685
TOTAL	12,469	179	11,262	114	3,891	039	4,034,365	59,951
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	21,205	004
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	21,205	004
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	3,850,032	58,266
RESTRUCTURED	000	000	000	000	000	000	719	004
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	12,469	179	11,262	114	3,891	039	204,819	1,685
NONACCRUAL	15,826	084	37,517	220	15,143	079	170,522	954
TOTAL	28,295	263	48,779	334	19,034	118	4,226,092	60,909
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	91.1	95.7
RESTRUCTURED	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	44.1	68.1	23.1	34.1	20.4	33.1	04.8	02.8
NONACCRUAL	55.9	31.9	76.9	65.9	79.6	66.9	04.0	01.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR -- FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	2,448,509	34,133
RESTRUCTURED	064	001	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	23,786	198	39,908	155	21,672	055	113,233	492
TOTAL	23,850	199	39,908	155	21,672	055	2,561,742	34,625
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	22,000	002
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	22,000	002
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	2,470,509	34,135
RESTRUCTURED	064	001	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	23,786	198	39,908	155	21,672	055	113,233	492
NONACCRUAL	5,678	024	31,650	050	20,085	038	25,109	076
TOTAL	29,528	223	71,558	205	41,757	093	2,608,851	34,703
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	94.7	98.4
RESTRUCTURED	00.2	00.4	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	80.6	88.8	55.8	75.6	51.9	59.1	04.3	01.4
NONACCRUAL	19.2	10.8	44.2	24.4	48.1	40.9	01.0	00.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	000	000
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	000	000
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	165	003
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	346	011
TOTAL	000	000	000	000	000	000	511	014
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	165	003
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	346	011
NONACCRUAL	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	511	014
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	32.3	21.4
RESTRUCTURED	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	00.0	00.0	00.0	00.0	00.0	00.0	67.7	78.6
NONACCRUAL	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

STATEMENT OF RAY MOSS TUCKER, CHAIRMAN
THE FARM CREDIT COUNCIL

I am Ray Moss Tucker, a farmer from Finchville, Kentucky. I am Chairman of the Board of The Farm Credit Council. I serve also as Chairman of the Council's Legislative Committee, and it is in that capacity that I appear before you today.

The Council was formed in 1982 and is the federated national association of borrower-owned farm lending institutions across the country, including all 37 of the nation's Farm Credit Banks and over 90 percent of all Production Credit and Federal Land Bank Associations nationwide.

With me at the table are James Roll, Senior Vice President of the Federal Farm Credit Banks Funding Corporation of New York; and Gene Swackhamer, President of the Farm Credit Banks of Baltimore. Following my statement, Mr. Roll will testify on the financial condition of the Farm Credit System and the problems which we face in marketing our securities. Mr. Swackhamer will conclude by presenting our proposal for government financial assistance.

Mr. Chairman, the banks and associations that make up the Farm Credit System are directed, by law, to serve the credit and financial service needs of U.S. agriculture. They are farmer-owned and farmer-directed organization, dedicated totally to the moving of capital on a dependable basis from the nation's money markets to U.S. farmers, ranchers and their cooperatives. They exist for no other purpose. The quality of our assets is fully dependent upon the financial health of agriculture and the rural economy.

At a meeting in mid-September the Boards of Directors of the 37 Farm Credit Banks received a report on the financial condition of the System and the market conditions for Farm Credit System-wide securities. Using USDA forecasts as well as our own, directors were briefed on the anticipated further deterioration in the nation's farm economy over the next two years. Their unanimous conclusion was that absent government financial assistance, the System cannot survive the radical transition underway in agriculture.

At that mid-September meeting, the Legislative Committee of The Farm Credit Council was authorized and directed to immediately develop and pursue on behalf of the Farm Credit System, a request for government financial assistance which would restore farmer and investor confidence in the System and permit it to carry out its mandate to provide a dependable credit source for U.S agriculture. I've attached the principles for seeking assistance which were adopted by the directors at the September meeting.

Mr. Chairman, I've been a long-time farmer-borrower from a PCA, president of a large borrowing cooperative and, for six years, a member of the Louisville District Farm Credit Board. I am proud of our farmer-owned System and of Congress for having the foresight to establish it some 70 years ago.

All of the System institutions--the Federal Land Banks, the Federal Intermediate Credit Banks (FICBs), the Production Credit

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	232	004	088	001	000	000	6,154,001	81,559
RESTRUCTURED	196	001	000	000	000	000	055	001
OTHER RESTRUCT. OR REDUCED RATE	445	001	1,413	009	000	000	13,971	056
OTHER HIGH RISK	20,026	174	62,381	598	2,635	025	236,866	3,641
TOTAL	20,899	180	63,882	608	2,635	025	6,404,893	85,257
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	17,569	003
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	17,569	003
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	232	004	088	001	000	000	6,171,570	81,562
RESTRUCTURED	196	001	000	000	000	000	055	001
OTHER RESTRUCT. OR REDUCED RATE	445	001	1,413	009	000	000	13,971	056
OTHER HIGH RISK	20,026	174	62,381	598	2,635	025	236,866	3,641
NONACCRUAL	22,434	109	189,930	925	13,062	041	477,847	679
TOTAL	43,333	289	253,812	1,533	15,697	066	6,900,309	85,939
PERCENTS-COMBINED AMTS								
PERFORMING	00.5	01.4	00.0	00.1	00.0	00.0	89.4	94.9
RESTRUCTURED	00.5	00.3	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	01.0	00.3	00.6	00.6	00.0	00.0	00.2	00.1
OTHER HIGH RISK	46.2	60.2	24.6	39.0	16.8	37.9	03.4	04.2
NONACCRUAL	51.8	37.7	74.8	60.3	83.2	62.1	06.9	00.8
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	4,683,451	63,418
RESTRUCTURED	886	003	000	000	233	002	391	013
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	487	005
OTHER HIGH RISK	35,368	422	103,910	676	17,971	124	94,021	2,691
TOTAL	36,254	425	103,910	676	18,204	126	4,778,350	66,127
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	6,630	089
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	6,630	089
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	4,690,081	63,507
RESTRUCTURED	886	003	000	000	233	002	391	013
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	487	005
OTHER HIGH RISK	35,368	422	103,910	676	17,971	124	94,021	2,691
NONACCRUAL	33,156	122	139,119	635	40,728	145	369,191	587
TOTAL	69,410	547	243,029	1,311	58,932	271	5,154,171	66,803
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	91.0	95.1
RESTRUCTURED	01.3	00.5	00.0	00.0	00.4	00.7	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	51.0	77.1	42.8	51.6	30.5	45.8	01.8	04.0
NONACCRUAL	47.8	22.3	57.2	48.4	69.1	53.5	07.2	00.9
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	4,205,262	58,810
RESTRUCTURED	072	001	000	000	000	000	2,431	022
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	14,404	169	77,477	500	11,395	076	282,128	1,901
TOTAL	14,476	170	77,477	500	11,395	076	4,489,821	60,733
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	13,499	002
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	13,499	002
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	4,218,761	58,812
RESTRUCTURED	072	001	000	000	000	000	2,431	022
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	14,404	169	77,477	500	11,395	076	282,128	1,901
NONACCRUAL	10,272	056	151,617	733	36,103	150	135,483	762
TOTAL	24,748	226	229,094	1,233	47,498	226	4,638,803	61,497
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	90.9	95.6
RESTRUCTURED	00.3	00.4	00.0	00.0	00.0	00.0	00.1	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	58.2	74.8	33.8	40.6	24.0	33.6	06.1	03.1
NONACCRUAL	41.5	24.8	66.2	59.4	76.0	66.4	02.9	01.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	2,698,354	38,873
RESTRUCTURED	000	000	000	000	000	000	3,354	014
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	544	005
OTHER HIGH RISK	9,691	120	2,997	026	660	004	31,512	387
TOTAL	9,691	120	2,997	026	660	004	2,733,764	39,279
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	000	000
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	000	000
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	2,698,354	38,873
RESTRUCTURED	000	000	000	000	000	000	3,354	014
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	544	005
OTHER HIGH RISK	9,691	120	2,997	026	660	004	31,512	387
NONACCRUAL	173	001	000	000	000	000	1,991	015
TOTAL	9,864	121	2,997	026	660	004	2,735,755	39,294
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	98.6	98.9
RESTRUCTURED	00.0	00.0	00.0	00.0	00.0	00.0	00.1	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	98.2	99.2	100.0	100.0	100.0	100.0	01.2	01.0
NONACCRUAL	01.8	00.8	00.0	00.0	00.0	00.0	00.1	00.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	000	000	000	000	000	000	4,040,937	22,449
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	25,574	125	32,787	118	10,275	029	261,690	935
TOTAL	25,574	125	32,787	118	10,275	029	4,302,627	23,384
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	33,587	002
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	33,587	002
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	000	000	000	000	000	000	4,074,524	22,451
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	25,574	125	32,787	118	10,275	029	261,690	935
NONACCRUAL	3,435	010	79,742	109	53,086	023	68,363	127
TOTAL	29,009	135	112,529	227	63,361	052	4,404,577	23,513
PERCENTS-COMBINED AMTS								
PERFORMING	00.0	00.0	00.0	00.0	00.0	00.0	92.5	95.5
RESTRUCTURED	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	88.2	92.6	29.1	52.0	16.2	55.8	05.9	04.0
NONACCRUAL	11.8	07.4	70.9	48.0	83.8	44.2	01.6	00.5
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

*** ALL DOLLAR AMOUNTS IN THOUSANDS ***

PRINCIPAL BALANCES OUTSTANDING BY BANKRUPTCY-FORECLOSURE STATUS

	IN BANKRUPTCY		IN FORECLOSURE		BANKRUPTCY AND FORECLOSURE		NOT IN BANKRUPTCY OR FORECLOSURE	
	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER	AMOUNT	NUMBER
LOANS								
PERFORMING	790	005	000	000	027	001	3,201,280	36,801
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	14,528	136	45,703	268	16,762	090	197,422	1,304
TOTAL	15,318	141	45,703	268	16,789	091	3,398,702	38,105
NOTES & CONTRACTS								
PERFORMING	000	000	000	000	000	000	000	000
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	000	000	000	000	000	000	000	000
TOTAL	000	000	000	000	000	000	000	000
COMBINED LNS,NTS & CONTRACTS								
PERFORMING	790	005	000	000	027	001	3,201,280	36,801
RESTRUCTURED	000	000	000	000	000	000	000	000
OTHER RESTRUCT. OR REDUCED RATE	000	000	000	000	000	000	000	000
OTHER HIGH RISK	14,528	136	45,703	268	16,762	090	197,422	1,304
NONACCRUAL	59,795	006	29,062	127	21,652	025	24,170	092
TOTAL	75,113	147	74,765	395	38,441	116	3,422,872	38,197
PERCENTS-COMBINED AMTS								
PERFORMING	01.1	03.4	00.0	00.0	00.1	00.9	93.5	96.3
RESTRUCTURED	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER RESTRUCT. OR REDUCED RATE	00.0	00.0	00.0	00.0	00.0	00.0	00.0	00.0
OTHER HIGH RISK	19.3	92.5	61.1	67.8	43.6	77.6	05.8	03.4
NONACCRUAL	79.6	04.1	38.9	32.2	56.3	21.6	00.7	00.2
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE: PERCENTAGES MAY NOT ADD DUE TO ROUNDING

Associations (PCAs), the Federal Lank Bank Associations (FLBAs) and the Banks for Cooperatives--have played a critical role in the development of U.S. agriculture. We believe that we have lived up to the intent of Congress that the Farm Credit System provide a dependable source of credit to agriculture.

Mr. Chairman, we are most proud of the fact that in 1968, the Farm Credit System became entirely farmer-owned when Federal capital was repaid!

Because we have been farmer-owned and directed for these past 17 years, our request for Federal assistance today is one of the most difficult decisions which we have ever made as an organization, but frankly speaking, we have no other choice.

We face $13 billion of problem loans with exposure to loan losses of $3 billion or more and another potential $3 billion of operating losses in 1986-87! It's a problem which has been developing for several years and which we have been trying to solve without government assistance for well over two years now.

Our problems are driven not by the actions of a single borrower or association or any combination thereof, but by an industry being torn apart by large supplies, declining exports, deflation and some of the highest real interest rates in history--all of which led to some of the steepest drops in land values ever in history.

Land values throughout the North Central and Midwest states have fallen by over 50 percent in the last five years, and the worst may not be over.

According to USDA data, over 215,000 farmers have debt-to-asset ratios above 70 percent and negative cash flow. They're in the most jeopardy of losing their farms in the next year to 18 months.

Some of our critics will argue that the System made decisions which brought on the very problems we are trying to come to grips with today. We are accused of making bad loans and encouraging farmers to expand when they shouldn't have. Hindsight is always 20-20. It points out the mistakes of Farm Credit banks and associations, commercial banks, farmers, farm journalists, agribusinesses, land grant university economists and ever government policies which encouraged fence-row-to-fence-row planting.

There's no doubt that the System made some weak loans, just as all lenders did. However, most of those $13 billion in now-troubled loans were sound loans when they were made, both from the standpoint of collateral and repayment. And most of them were made to good farmers. Furthermore, we didn't and they didn't mismanage the whole of rural America.

Bad loans alone are not the cause of the serious, underlying problems in agriculture which we are all working to solve. No one could have forecasted the dramatic devaluation in the balance sheet of U.S. agriculture. And no financial institution with its assets fully in that industry could have been capitalized high enough to weather the shock moving through this industry.

In the Louisville district, for example, we currently have almost 3,000 loans totaling $537 million on which the payments aren't being made! And there's upwards of 11,000 additional loans amounting to $1.5 billion which may be in trouble next year!

What we propose today is a program of continued self-help among these farmer-owned organizations with a life-line or safety net to government. I emphasize this is continued self-help. the financial stress among farmers and its impact upon these institutions are subjects we've been facing and managing for several years. Our goal has been to ensure that the Farm Credit System continued to be a reliable supplier of credit and services at the lowest reasonable cost to farmers, ranchers and their cooperatives.

I would like to highlight a number of the comprehensive self-help measures taken by the System to date.

First, at the district level, carefully planned loss-sharing agreements were entered into among PCAs. These agreements were to take effect only after an association had used its own loss reserves, current income and usually 10 percent of its surplus. But, we did not ask any association to impair its farmer-borrowers' stock. These loss sharing agreements have been triggered among PCAs in three-fourths of the districts over the past three years.

Second, on a case-by-case basis, district banks have provided financial assistance under agreements entered into between the assisted association and its supervising bank. This mechanism was to be used only if local resources and intra-district association loss-sharing could not maintain the viability of the local association. In the case of PCAs, help came in the form of an investment from the Federal Intermediate Credit Banks, either by the purchase of non-accrual assets--primarily non-accrual loans and acquired property--or by the the direct infusion of capital. All twelve district FICBs made some such investments in local PCAs, amounting to more than $181 million at June 30, 1985. Subsequent to June 30, 1985. Subsequent to June 30th, the Omaha FICB had invested about $120 million in its PCAs, $75 million of which was financed by other district banks.

Third, if the financial stress within a district were such that the viability of a district bank were in jeopardy, inter-district capital preservation agreements would be activated. The troubled banks were required to look first to their sister banks within their districts for assistance, and then, in recognition of the joint and several liability of the 37 Banks on all System-wide obligations, to all System banks. We've had these agreements in place since the late 1970's.

To supplement capital preservation agreements among the districts, special inter-district assistance programs were developed and applied for the first time in 1985, to assist the Spokane and Omaha Federal Intermediate Credit Banks. To help those two banks alone, the other banks of the System committed a total of $476 million--$136 million for the Spokane FICB and $340 million for the Omaha FICB.

Fourth, to facilitate and to administer those assistance plans, the 37 Farm Credit Banks chartered and capitalized the Farm Credit System Capital Corporation -- headquartered in Wichita, Kansas -- specifically to acquire -- on behalf of all

37 banks -- the non-accrual assets of troubled banks in Omaha and Spokane.

Fifth, to better protect the farmer-borrower's stock investment, to cut costs and achieve operating and organizational efficiencies, a number of districts have developed--and some have implemented-- proposals to pool the capital of PCAs within the district through consolidations of associations into single, district-wide organizations, or through expanded district loss-sharing programs. To date, seven of the twelve districts' farmer boards of directors of PCAs have approved such proposals. In two districts, those proposals have already won the required stockholder approvals and are now being implemented. In three districts, FLBA boards of directors have voted to form a district-wide FLBA. One of those proposals has been presented for and has received stockholder approval. And, I think it's important to note, Mr. Chairman, that in every instance, these votes have been by very decisive margins, which we would be pleased to provide to the Committee.

Sixth, in recent years the districts made substantial progress in establishing single Farm Credit service centers in communities which have both a PCA and Federal Land Bank Association. These actions have already resulted in elimination of duplicate facilities, reduced overhead in improved coordination in the extension of credit to our farmer stockholders.

Seventh, we've consolidated the management of the district banks--the Banks for Cooperatives, the Federal Intermediate Credit Banks and the Federal Land Banks. Of ten districts which now have consolidated management for the three district banks, eight of those consolidations have occurred since 1982. Again, the result is more effective use of executive talent, reduced overhead and improved coordination in credit programs and services.

Eighth, we've cut staff. In 1985, we will have reduces System-wide employment by 10%--over 1,700 people--to an estimated 15,600 by the end of this year. Some district banks have suffered staff cut-backs of 30 percent. This represents a cost savings of approximately $60 million per year.

Ninth, apart from these issues, the System banks and associations have recognized their losses. Between 1982 and 1984, charge-offs totalled $1 billion. This year alone, we expect charge-offs among System banks and associations to exceed the amount of the previous three years combined.

These steps have helped us absorb third quarter losses by the 37 Banks of $552 million, the first aggregate loss reported by the 37 Banks since the 1930s!

Mr. Chairman, the actions just described have not been universally popular, but they have been undertaken in good faith and with critical input from our farmer-stockholders. We're in a predicament as farmers and directors of the Farm Credit system. On one hand, we see firsthand, the gut-wrenching problems which result from the lack of profitability in agriculture. On the other hand, as directors, we set policies to maintain the viability of our associations, even though this may result in higher interest rates to farmers.

Perhaps it is because we are farmers and have believed that the ag economy would turn around that we have stayed with farmers as long as we have. Some would say we've stayed too long, or else we wouldn't be projecting $6 billion in non-accrual loans by the end of this year and $13 billion over the next two years. Many of these loans would have been liquidated over the past six years had we pursued more aggressive credit administration practices.

We have worked hard to carry out a responsible policy of forebarance; but there are still at least three problems with such a policy: (1) you can never have done enough of it; (2) it can only be rationalized if there's a reasonable expectation that financial health will be restored to the borrower or, in this case, the industry; and (3) it costs money--in the form of carrying cost on non-accrual loans--and this cost is borne by the remaining borrowers through higher interest charges.

Frankly, these costs have come home to roost. The resulting higher rates are driving farmers who can't refinance toward bankruptcy at an accelerating rate. These same higher rates are driving farmers who can refinance to other lenders. Still others flee out of fear that their stock investment in System institutions will soon be lost. The result is a downward spiral of confidence and capital base for the System institutions will soon be lost. The result is a downward spiral of confidence and capital base for the System as a whole. During the first three quarters of 1985, the loan volume of the Farm Credit Banks fell by more that $6 billion!

We know the importance of helping farmers get through the tough times. After all, many of these same farmers helped build the Farm Credit System. But we also recognize that realistically some farmers still aren't going to survive even with maximum forebearance, because of the lack of profitability in agriculture today.

Mr. Chairman, the Farm Credit System has a solid record of assisting agriculture and repaying the government capital it was provided during its early years. The government's initial investment was a partnership with the American farmer. It made good business sense and good policy. Now, seventeen years after we repaid that initial investment, we are once again asking you to help us ensure that the Farm Credit System continues to be able to live up to its Congressional mandate. We have tried and we will continue to try to solve our financial problems with our own resources, but these resources simply are not going to be enough! We need your help now in this session of Congress.

Thank you.

PRINCIPLES FOR SEEKING FEDERAL ASSISTANCE

1. Assistance should be for the minimum amount necessary and of the shortest duration possible to enable the System to continue to perform its Congressionally-mandated mission.
2. Levels of assistance must be sufficient to strengthen borrower confidence, and assure full and timely payment of principal and interest to holders of System securities.
3. Farmer-borrower control of the System should be maintained.

4. Government involvement in the System decision-making process should be minimal.
5. Extension and administration of credit should not be politicized.
6. Except for ongoing regulatory supervision, the government's involvement with the System should end with the expiration of any assistance package.
7. Expanded lending authorities are not contemplated.
8. The System should not be mandated to assume any of the lending activities now held by government agencies.
9. Significant structural changes for System institutions, required as a condition for financial assistance, must receive further approvals.
10. The System recognizes the need for a strong and independent Federal regulator and will support statutory changes to give the Farm Credit Administration powers similar to those held by other financial regulatory institutions, while also reducing the involvement of the Farm Credit Administration in the management of the banks.

Approved by the Farm Credit Districts
September 17, 1985

STATEMENT OF JAMES A. ROLL, SENIOR VICE PRESIDENT FEDERAL FARM CREDIT BANKS FUNDING CORPORATION

I am James Roll, Senior Vice President of the Federal Farm Credit Banks Funding Corporation, located in New York City. Unlike many financial institutions which generate loanable funds primarily through deposits, the Farm Credit System funds itself almost entirely through the issuance of securities in the capital markets. Currently, securities outstanding total nearly $70 billion.

Our role at the Funding Corporation is to direct the marketing of securities of the 37 Farm Credit Banks. We work with an independent selling group of approximately 150 securities firms and bank dealers who offer Farm Credit securities on a world-wide basis. Our investors include commercial banks, savings and loan associations, individuals, insurance companies, states and municipalities, pension and money market funds, foreign banks and governments and others.

Today, I will discuss the financial condition of the Farm Credit System, how the financial community has reacted to the current agricultural situation and its impact on the system.

Like other financial institutions, the Farm Credit System is subject to a wide variety of influences, both real and perceived, which affect our ability to successfully market our securities. This, in turn, affects both the interest rates which we charge to farmers and our financial statements. With a depressed agricultural economy and a fragile market for our securities, these influences have a more pronounced impact.

First, it's important to understand that although we clearly state that Farm Credit system securities are not an obligation of, nor guaranteed by the U.S. Government, the market for System securities is nevertheless supported by a firmly held belief that because we are a government-sponsored financial institution, our securities are backed by the government of the United States. This is why there continues to be a market for our bonds today, despite our growing financial problems.

As Mr. Tucker said a few minutes ago, the Farm Credit System has identified potential nonearning assets of about $13 billion and a potential exposure to loan losses of $3 billion or more by December 31, 1987.

Mr. Tucker also spoke to the upward pressure on interest rates charged to farmers and cooperatives that results from the rapidly increasing cost of carrying these nonearning loans and acquired properties. As the financial markets become more uneasy with our financial problems, our increased costs for funds will result in interest rates to farmers that are even higher.

Heightened investor concern could mean that we become unable to market securities at all, and thus would not be able to repay our existing securities when they mature. As our interest rates rise, we lose our best borrowers. If we lose access to the market, we would soon default on our obligations. This is what the Farm Credit System faces absent government financial assistance. With that brief preface, I'd like to discuss what has already happened in the markets.

The financial community did not begin to focus on the problems in the agricultural economy until late 1984 or early 1985. Concern about agricultural conditions was heightened last spring with major articles focusing on agriculture's problems.

At the same time, the System's regular quarterly reports and periodic press releases on the financial condition of the Farm Credit Banks increasingly pointed out the adverse industry trends that were affecting System borrowers. While investors showed some concern about the problems of individual Farm Credit districts, overall, they continued to believe, as we did at the time, that the total System remained financially sound.

By early summer, this view began to change. Depressed commodity prices and slumping land prices began to be reflected in System financial statements. In mid-July, concern was heightened by reports that the System would experience significant loan losses. Our funding costs increased about 1/4 of 1 percent (25 basis points) in late July.

During August, the system released results of second quarter operations, projecting that the 37 Farm Credit Banks would incur an operating loss for the third quarter of 1985, and--based upon what was known at that time--might incur an operating loss for the year.

During the first week of September, the market received the news that plans were being made to seek Federal assistance for the Farm Credit System. While this news was taken adversely, questions of an even more serious nature were raised concerning the number and amount of loans which might be uncollectable and how high our losses might run.

Wall Street reacted quickly, and as a result, the cost of new sales of Farm Credit securities increased another 1/2 to 3/4 of

1 percent above the U.S. Treasury rate. Toward the end of September, spreads over Treasury rates stabilized in the 3/4 - 1 percent range.

But this stability didn't last long. During the second week of October, the market was shaken again. The System's cost of funds increased an additional 1/8 -1/4 percent, but a more important result was that the System can no longer sell issues of the size and in the maturities that fit its funding needs. Spreads are now between 1 and 1-1/4 percent over Treasury rates.

These so-called "shocks" to the market have a real impact. To give you a quick example, each year we market about $100 billion in securities. If our costs are 1 percent higher, the added cost on that $100 billion is $300 million in the first year alone, and that cost is ultimately paid by farmers!

While our cost of funds is important, the impact on the market for Farm Credit securities has gone far beyond the cost consequences alone. We have lost many of our traditional investors in Farm Credit securities who purchased them as a direct substitute for U.S. Treasury securities. System issues were quality investments. Now, because of the questions about our future, these investors have either sold their holdings or are holding them to maturity and not reinvesting.

Who are these traditional buyers? They include commercial banks, state and local governments, mutual funds and other institutional investors, who because of their fiduciary responsibilities, must be able to show that they have invested prudently. Because of the problems which we have and are trying to solve and the questions which others are raising about the Farm Credit System, it is very difficult for these investors to justify why they should continue to purchase System securities.

Consequently, the Farm Credit System has attracted a new type of investor, one who is willing to accept risk for a price. This investor believes that our securities represent an opportunity to earn a high return because they ultimately believe the Federal government will not let the Farm Credit system default.

If, however, the day should come that serious questions are raised about the commitment of the Federal government to the Farm Credit System, this new investor will also abandon System securities and the source of funds for farmer loans could dry up, regardless of price!

Last week, the System issued its Third Quarter Financial Report. In it, losses for the combined 37 Banks were reported for the first time since the 1930s. These losses totaled $522 million for the quarter and $426 million for the nine-month period ended September 30th. These losses were a direct result of a substantial provision for loan losses and the cost of the financial assistance package for the Omaha Federal Intermediate Credit Bank.

In view of depressed net farm income and declining farm land values, particularly in the Midwest, earlier this year we undertook a special nationwide credit review of the Federal land banks. This was initiated to help determine the likelihood of land borrowers repaying their notes (both principal and interest). This review showed that approximately $6 billion of the total of $48 billion in loans outstanding are currently undercollateralized by approximately $900 million. That is, the land serving as collateral is worth less than the mortgage on the land. As a result of this study and a general deterioration in our loan portfolio, the provision for loan losses was $675.9 million for the first nine months of 1985, compared to $77.4 million for the same period last year.

In addition, non-accrual loans increased during the third quarter to $3.5 billion or almost 5 percent of loans outstanding, nearly double the amount reported on July 30, 1985. Non-accrual loans are those for which accrual of interest has been suspended because of substantial doubt about the ultimate collection of principal and interest.

Based on the special credit review of Federal land banks and other economic studies, the Farm Credit Banks may be exposed to loan losses aggregating $3 billion or more during the 1985-1987 period for which an allowance for loan losses of approximately $1.1 billion bas been established as of September 30, 1985.

While I cannot predict the fourth quarter results for the System, I can tell you that we will make the necessary additions to the allowance for loan losses based on a further analysis of the loss exposure in the Banks' individual loan portfolios.

We stated in our quarterly report that the level of non-earning assets between now and the end of 1987 may be $10 billion or more. Obviously, not all non-accrual loans will result in losses to the System. However, the cost of carrying this magnitude of nonearning assets and absorbing $3 billion or more in loan losses will likely result in multi-billion dollar net operating losses for the next several years!

I believe the market for Farm Credit securities would not tolerate losses of this magnitude without explicit evidence of government assistance.

We are striving to accurately reflect where we are and appropriately disclose information as soon as it is known by the banks. Furthermore, we are sensitive to the necessity for public confidence. This was the primary reason that the System retained the services of Price Waterhouse as auditors this year. They have been working in each Farm Credit Bank toward the objective of presenting audited financial statements for the year ending December 31, 1985. I am confident that the Farm Credit Banks will take whatever actions are necessary to earn an unqualified opinion from Price Waterhouse.

As I indicated earlier, each year we at the Funding Corporation issue upwards of $100 billion in bonds and discount notes on behalf of the Farm Credit System. While this total will be reduced somewhat this year as a result of loan payoffs, on a continuing basis the System needs to roll over outstanding debt of approximately $70 billion.

Continued deterioration in the financial condition of the Farm Credit System without explicit government assistance will increase the risk that the System will not be able to meet its funding needs at any cost! This could ultimately result in an immediate financial crisis in terms of the System's ability to meet its maturing obligations. At the end of the third quarter, 37 Bank liquidity--that is investments in liquid securities and cash--amounted to $5.3 billion. This is our cushion of liquid assets that would be used to retire maturing bonds and discount notes in the event the System were unable to go to the market. On average, the System must raise over $1.5 billion each week. In other words, absent government financial assistance or intervention, the System could continue in business for about 18 days, if it were unable to market its obligations!

Mr. Chairman, the Farm Credit System is at a major crossroads in its history. We continue to believe that we have provided sound lending to farmers, ranchers and their cooperatives within the limits established by the Congress. We can continue to fulfill that mission, but, in my professional opinion, we will not be able to do so without government assistance to ensure investor confidence and financial stability of the System.

STATEMENT OF GENE SWACKHAMER, PRESIDENT FARM CREDIT BANKS OF BALTIMORE AND MEMBER OF THE LEGISLATIVE COMMITTEE OF THE FARM CREDIT COUNCIL

My name is Gene Swackhamer. I am President of the Farm Credit Banks of Baltimore. I am pleased to appear before this Committee today as a member of The Farm Credit Council's Legislative Committee.

Mr. Chairman, today we are seeking the assistance of Congress and the Federal government to avert two potential crisis of serious proportion for American agriculture and the nation's economy.

The first is a potential funding crisis. It is critical that investor confidence in the Farm Credit System be restored immediately. The System funds one-third of the nation's farm debt and one-half of farm real estate debt.

The second is a potential financial crisis as the precipitous decline in farm real estate values and lack of farm business profitability depletes the financial resources of Farm Credit banks, associations and their farmer-stockholder-borrowers. These conditions further compound the problems of a downward spiraling farm economy leading to a crisis of confidence by farmer-borrowers and their cooperatives in the Farm Credit System. The System's deteriorating financial position leads directly to questions of Farm Credit System reliability as a source of credit at reasonable rates.

Mr. Roll has already described how Wall Street has reacted to the System's problems. In the space of three months, Farm Credit securities have gone from a better-than-AAA investment to being described by an article in the October 28th Washington Post as "junk bonds". Another report that Standard and Poor's is considering a change in the Farm Credit System's status as an approved investment for AAA-rated companies has heightened investor concern about System viability, absent government financial assistance.

The ripple effect of a Farm Credit System default on farmers, the financial markets and on our nation's economy in general would be devastating. Chase Econometrics is analyzing this issue in some detail for us and their preliminary findings show an impact more on the order of a tidal wave than a ripple.

A System default would mean that approximately 90,000 farm operators nationwide would have their loans foreclosed in the first year after default. Interest rates paid by farmers are likely to increase by 3 1/2 - 4 1/2 percent and there is the likelihood of a $22 to $39 billion credit shortfall to meet agricultural production expenses.

Because of their holdings of Farm Credit securities, the 3,900 agricultural banks throughout rural America would lose over a third of their capital. As a whole, the nation's banking industry would lose close to 10% of its capital in the first year and would experience additional losses as other agricultural loans go bad.

Secondary economic impacts are no less dramatic:

- -- interest rates outside agriculture would likely increase by 2 1/2 - 3 percent, resulting in slower growth in the economy,
- -- an estimated 1.5 million jobs would be lost,
- -- an increase of $53 billion in the Federal deficit would result.

Shocks to the economy of the nature being estimated in this study can be prevented with explicit government guarantees and financial assistance. The first requirement is to stabilize the market for System obligations. This will ensure the continued flow of capital to farmers through the Farm Credit System, while it reduces System funding costs and helps prevent significant and devastating increases to farmers' interest rates. In my opinion, this will calm Wall Street. But, the Chase study confirms that the reasons for allaying Wall Street concerns about the quality of Farm Credit investments extend far beyond the System and the farm economy.

We have considered the usefulness of Federal guarantees on System securities. It is only a partial solution. It does not ensure that the System will have the capital resources necessary to permit restructuring of nonperforming loans, holding liquidated property off the market or absorbing significant loan losses without forcing the System to substantially raise interest rates!

The second problem we must face is how to solve the critical financial problems of farmers and their Farm Credit System. According to USDA's data, as of January 1985, farmers leveraged greater than 40 percent who also had negative cash flows in 1984 owed the System $18.7 billion. Those in the most immediate trouble--having both a debt/asset ratio of greater than 70 percent and negative cash flow--owned the System $8.6 billion. A total of $3.5 billion in System loans is owned by farmers with debt-to-asset ratios over 100 percent. The System will incur significant losses which will further deplete the System's capital, regardless of the efforts made to collect these loans.

At year-end 1984, the 37 Farm Credit Banks, together with the production credit and Federal land bank associations, had total risk funds--capital and loss reserves--of $13.1 billion with non-accrual assets amounting to $2.5 billion. By September 30, 1985, risk funds had dropped to $12.8 billion and non-accrual loans will reach $6 billion. The magnitude of the loss for calendar 1985 is dependent on the necessary addition to the allowance for loan losses which will result from loan portfolio studies currently being performed.

As Mr. Roll testifies, we expect that some $13 billion in loans now outstanding will fall into non-accrual status in the next two years. Even with aggressive management of troubled loans, the level of loans in non-accrual status is now forecasted to reach $11.0 billion by December 31, 1987, at which time risk funds of the system are projected to have fallen to $6.9 billion. Of that $6.9 billion, however, $4.9 billion will be farmer-invested stock. In other words, at that point in time, if all the surplus and loss reserves of the 37 banks and nearly 700 associations were combined into one account, the System would have to net $9 billion in recoveries on $11 billion in non-accrual loans to avoid the impairment of farmer-borrower stock throughout the System. Given the current condition of the agricultural economy and the required rapid movement of land onto already depressed real estate markets, it is very unlikely that the System can avoid significant impairments of farmer/borrower stock without government assistance.

Frankly, we do not think it is very likely that the System could endure through 1987. With rising loan losses, increasing costs of carrying non-earning assets resulting in successive years of multi-billion dollar operating losses System-wide, we believe the investors would abandon the system prior to year-end 1987, without government financial assistance!

Even if the Federal government can give some assurance to the financial markets, an equally serious problem remains for the System's farmer-stockholders. Borrowers who have the financial condition which permits them to seek another lender will continue to do so, if the government does not assist the System. This, too, hastens the ultimate financial collapse of the System as farmers' capital is withdrawn, leaving the burden to other farmer-borrowers.

Mr. Chairman, as we considered various options for government assistance, we have been ever-mindful that almost $11 billion of the $13 billion in non-accrual loans expected by the end of 1987 will surface from within the Federal land bank portfolios. As the holder of one-half of U.S. farm real estate debt, we are greatly alarmed by the likely consequences upon farm real estate values, if the land banks have almost 20 percent of their loans in the process of liquidation in the next two years!

This underscores the unique role and responsibility of the Farm Credit System in relation to the farm economy. It is on the basis of this special role and responsibility that we call upon the Congress to once again join with the Farm Credit System in a program of System self-help and government assistance to help farmers, ranchers and their cooperatives through this most difficult period for American agriculture.

The objective of our proposal is brief: to help restore stability to farmland values and to assure farmers, ranchers and their cooperatives that credit will continue to be available at reasonable cost through the farmer-owned and directed Farm Credit System.

We stand ready to work with you and your staff in preparing and perfecting draft amendments to the Farm Credit Act that would permit these farmer-owned institutions to implement self-help measures through the Farm Credit System Capital Corporation as mentioned earlier by Mr. Tucker.

The Capital Corporation is a service corporation chartered by the 37 Farm Credit Banks in 1985 for the purpose of mobilizing system resources and overseeing System financial assistance to the Omaha and Spokane Federal Intermediate Credit Banks and their related associations.

We believe that the concept of System self-help embodied in the activities of the Capital Corporation is sound. It is the most efficient vehicle to aid the farmer-owned and directed Farm Credit System, if the Farm Credit Administration is authorized to supplement the resources of the system. The Capital Corporation is in place, operating, and, we believe with minor additions to its authorities, it could readily be used to facilitate a program of assistance for troubled institutions of the System. It will also help moderate the otherwise extreme results from rapid adjustments in U.S. agriculture.

The Proposal

Specifically, our proposal would:

o Empower the Farm Credit System Capital Corporation to serve as a financial warehouse through which System institutions and government would share in the mounting costs of carrying non-accual loans and acquired properties marked to economic value, and in other temporary financial assistance essential for the survival of troubled farmer-owner System institutions.

o Authorize the Capital Corporation to mobilize available System capital through assessments on system institutions, consistent with standards to be established by the Farm Credit Administration. These standards would guard against undue increases in interest rates to farmers in contributing districts, and so that district institutions can plan for their own financial affairs, such assessments could not exceed one-half of one percent of interest accruing assets.

o Incorporating moneys available through FCA's present revolving funds, authorize FCA to immediately supplement system financial self-help measures through a provision for loans from the U.S. Treasury of up to $6 billion, not to exceed $2 billion in any fiscal year.

o Require the System to repay assistance through assessments by the Capital Corporation as System institutions are able to repay consistent with regulatory standards established by FCA.

o Require, consistent with conditions of prior Federal assistance to the System, the payment of annual fees equal to the Government's cost of funds or 25 percent of System earnings, whichever is the lesser, for so long as such loans are outstanding.

o Maximize local accountability by requiring that as a condition of assistance through the Capital Corporation, a troubled bank or association shall have first reasonably drawn upon the financial resources of other institutions within its district.

o Supplement the existing powers of the Capital Corporation to provide it with the operational tools and flexibility necessary to carry out broadened responsibilities; the authority to extend credit and rework loans and to assess banks for system capital assistance.

o Provide for the continued local loan administration, restructuring and management of troubled loans, related assets and acquired property.

o Cause FCA to set regulatory guidelines for loan restructuring and property management taking into account such things as local farm real estate market conditions, production value of real estate collateral, conditions under which foreclosed property may be leased back to qualified borrowers, terms under which System institutions will secure the amount of any deferred principal through participation in future appreciation of collateral or other means. Such guidelines would be implemented in policies of the Capital Corporation and would apply in districts which receive inter-district or government assistance.

o Authorize FCA to increase legal debt to capital limits for PCAs (now 10 to 1) to up to 20 to 1 thus avoiding many otherwise necessary liquidations of troubled PCAs.

In addition, we recognize that as a part of any Federal financial assistance, the public must be assured of the safety and soundness of its investment in the System. As a part of any such assistance, the System will support legislation which will provide enhanced regulatory powers for the Farm Credit Administration, coupled with a withdrawal of the agency from participation in management and business policy determinations of System institutions. We believe that the enforcement powers of the FCA should be no more or no less than those exercised by other Federal regulators of financial institutions.

Benefits

With these additional authorities, Mr. Chairman, and with financial assistance from the Federal government, we believe:

o Farmers benefit as costs of carrying non-accrual assets are shifted off the books of troubled banks and associations; and costs of System borrowing are reduced as investor confidence is restored, thus reducing pressure on interest rates.

o Farm foreclosures and bankruptcies are minimized as a direct result of financial assistance that permits more orderly and reasonable workout and restructuring alternatives under FCA regulatory guidelines.

o Farmland values are stabilized as financial assistance in carrying non-earning assets relieves the pressure on troubled institutions to rapidly sell properties in inventory. By restructuring troubled loans to reflect current economic value, System institutions will signal the real estate market that an underlying value is being established for farmland by the nation's principal farm real estate lender.

- The Farm Credit System can continue as a viable and dependable provider of credit and related services at reasonable costs.

The Impact of No Assistance

As single industry lenders, with their loan assets totally dependent upon a rapidly deteriorating farm economy, the banks and association of the Farm Credit System are being squeezed in a financial vise: with rising costs of funding and increasing levels of non-accural assets they must raise interest rates to farmers--a substantial portion of whom cannot pay the present rates. This further aggravates the financial plight of those who cannot refinance and drives away those who can. As interest rates increase, the System's capital and earnings' base erode. And as the institution feeds on itself, the investors demand ever higher rates until they finally quit purchasing System securities entirely.

Faced with these alternatives, and absent government financial assistance, system banks and association will be forced to minimize the rate of capital erosion by:

- Accelerating the collection of delinquent loans to minimize the burden on non-earning assets.
- Increasing interest rates to borrowers to cover the higher costs of purchased money and the carrying costs of non-accrual loans and acquired property.
- Aggressively marketing invertoried properties, resulting in additional stress on the already depressed and soft farm real estate markets.
- Pressing forward with widespread consolidations of associations to most efficiently utilize capital remaining within the System

Finally, the Farm Credit Administration had indicated that without financial assistance:

- at least 40 production credit associations will be liquidated or forced to consolidate within a few months,
- as many as three Federal intermediate credit banks and two Federal land banks will meet the same fate within a year. The result would be serious loss of confidence and stockholder investments by hundreds of thousands of the System's farmer/owners.

Mr. Chairman, the System-wide obligations which fund the operations of the Farm Credit System are the joint and several obligations of the 37 Farm Credit Banks. We are in debt together and the inability of the System to market those securities could bring the total of the System to its knees in less than three weeks. This fact often masks the reality that these banks and associations are not a single institution, but rather, they are a group of farmer-owned and farmer-directed, locally based farm lending cooperatives knit together by a common charter Act, a common regulator and their co-responsibility on obligations issued through a common funding source. Thus, absent a collapse of the bond market, the financial problems facing the system will not bring it crashing down all at once. At an accelerating pace, however, individual institutions will fail, association by association, and then bank by bank.

It must be emphasized, though, that the farmers and cooperatives who borrow from these institutions own them as well. They are the ones who would be helped most by assistance to these institutions. The converse of this statement, though, is just as true. Those who will be hurt most should the Farm Credit System not receive financial assistance will be those same borrowers and owners of the Farm Credit System banks and associations--some one million U.S. farm families.

We believe it is imperative that steps be taken in this session of the Congress to restore both farmer and investor confidence in the Farm Credit System. We dare not leave the financial markets unsettled while Congress is in recess. Farmers must be assured now that their Farm Credit System will continue as a dependable provider of credit and related services in 1986 and subsequent years. We believe that a mechanism for financial assistance must be in place before farmers come in to set up their loans for refinancing in 1986.

For The Farm Credit Council and its member banks and associations of the Farm Credit System, we offer these proposals for your urgent consideration. As you consider them, we urge you to remember why your predecessors in the Congress established the Farm Credit System, the excellent record of service to agriculture and the fact that the System has already proven its credit record with government. It has repaid its government capital in the past. It will again.

[News Release from the Farm Credit Council, Oct. 31, 1985]

FARM CREDIT SYSTEM PROPOSES SELF-HELP AND ASSISTANCE PLAN

WASHINGTON -- Because of continuing deterioration in the U.S. agricultural economy, the Farm Credit System today proposed a self-help and federal financial assistance package designed to help relieve the financial stress on farmers and to restore stability to the farmer-owned nationwide agricultural lending system. The Farm Credit System is the nation's largest single provider of credit and related services to American agriculture.

In testimony before the Senate Agriculture Committee, representatives of the Farm Credit system documented the crisis affecting the nearly one million U.S. farm families who are borrower-owners of the System. The System spokesmen proposed amendments to the Farm Credit Act of 1971 which would create a new partnership of System self-help and federal aid.

System spokesmen said that, without government financial assistance, the Farm Credit System's ability to continue as a dependable provider of financing to U.S. agriculture is in serious question.

As a single industry lender in a severely depressed industry, the System would have no choice but to take steps to preserve the capital positions of its banks, they said. Such steps would include accelerating collection of delinquent loans, increasing the rate of foreclosures, seeking to sell acquired properties more aggressively in an already depressed real estate market, and raising interest rates charged to farmer-rancher borrowers.

Presenting the legislative proposal were Ray Moss Tucker, a Finchville, Kentucky dairy farmer who is chairman of the board of The Farm Credit Council as well as chairman of its legislative committee; James A. roll, senior vice president of the Federal Farm Credit Banks funding corporation, New York; and Gene Swackhamer, president of the Farm Credit Banks of Baltimore.

Severity of the Problem

The Farm Credit System proposed its legislation as problems besetting the nation's agricultural sector have reached critical proportions. These severe difficulties have been fueled by shrinking markets for U.S. farm exports, a strong dollar, lower commodity prices and a marked decrease in farm land values.

While farmers' operating costs have continued to rise, their cash flow has diminished and interest rates have continued to climb rapidly, pushed upward in part by their lenders' need to cover the costs of mounting loan losses and nonearning assets as well as by the federal deficit. More recently, erosion of investor confidence in Farm Credit securities has increased the System's cost of funds. Interest payments have become the largest single operating cost for farmers with debt. At the beginning of 1985 farmers and ranchers owed their lenders about $213 billion, with approximately one-third of that amount loaned by the Farm Credit System.

According to the U.S. Department of Agriculture, a substantial portion of the Farm Credit System's loan portfolio is in a serious financial condition. As of January 1, 1985, $27 billion was owed by farmers who had negative cash flows; $10.1 billion was owed by farmers who had negative cash flows and debt to asset ratios of between 40 percent and 70 percent; and an additional $8.6 billion was owed by farmers with negative cash flows and who were leveraged greater than 70 percent.

The System's own financial data reflect the severe stress. In the third quarter of 1985, the 37 Farm Credit Banks lost $522.5 million. As of September 30, 1985, the System had $3.5 billion of non-accrual loans -- an increase of 118 percent in the last six months. The System also projects that total non-accrual loans and acquired property will likely reach $6 billion by year-end 1985. Even with aggressive management of troubled loans, system officials forecast that the level of loans in non-accrual status will reach $11 billion by December 31, 1987.

Proposal

As presented to the House Agriculture Subcommittee, "The Farm Credit System Self-Help and Federal Assistance Act of 1985" would provide immediate authority for the Farm Credit Administration (the federal agency which regulates the Farm Credit System) to supplement System financial self-help measures by providing from the U.S. Treasury to the Farm Credit System

Capital Corporation up to $6 billion, not to exceed $2 billion in any fiscal year. These funds would enable the Capital Corporation to act as the System's capital marshalling arm to provide financial assistance to System institutions so that they could carry the cost of non-accrual loans and acquired property.

System institutions eligible for financial assistance through the Capital Corporation would include Federal Land Banks, Federal Land Bank Associations, Federal Intermediate Credit Banks, Production Credit Associations and Banks for Cooperatives. Before receiving any financial assistance for the Capital Corporation, a system institution first would be required to draw on the financial resources of the other institutions in its district.

Under the proposal, the Farm Credit Administration would be authorized to issue regulations prescribing the factors that the Capital Corporation must consider in making a determination of financial need.

As the vehicle to manage the System's financial self-help program and to receive, administer and repay any financial assistance provided by the federal government, the Capital Corporation would be granted additional authorities. These authorities would include the ability to require a bank to participate in Systemwide assistance through the purchase of stock in the Capital Corporation, authorization for the Corporation to purchase stock in financially stressed System institutions, and the authority to make assessments of System institutions.

The proposed legislation provides for the Farm Credit Administration to issue regulations setting the criteria under which the Capital Corporation could make assessments or require system institutions to purchase Corporation stock. This would guard against undue increases in interest rates to farmers in contributing districts, and allow district institutions to plan their own financial affairs.

The FCA criteria would be designed to assure that the capital strength and earnings capacity of the institutions is such that credit will continue to be available to eligible borrowers in each district at reasonable rates and on a sound business basis. Also assured would be farmers' continued access to the public financial markets through the Farm Credit System's funding mechanism.

In addition, the FCA would set regulatory guidelines for loan restructuring and property management. These guidelines would be implemented in policies of the Capital Corporation and would apply in districts which receive inter-System or government assistance.

Benefits of Proposal

The Farm Credit System's proposal offers a number of benefits to farmers and ranchers and to U.S. agriculture overall. It would contribute to stabilization of farm asset values by reducing the pressure on banks and associations to acquire and liquidate loan collateral. In addition, it would provide greater opportunity for financially stressed farmers to adjust to changing market conditions and financial demands.

Also, the proposal would focus accountability for overseeing the workout of problem loans and loan-related System assets in a way that optimized return to both lenders and borrowers. It would reassure investors of the System's ability to meet its debt obligations, stabilize the System's funding costs and relieve upward pressure in interest charges to borrowers.

The System's proposal is designed to minimize the taxpayer expense of creating the needed debt adjustment in U.S. agriculture while preserving the Farm Credit System's future viability as the major source of dependable financing and service to U.S. agriculture.

Stabilizing the financial condition of the nation's largest farm lender, System spokesmen testifies, not only will help restore order in the troubled rural economy, but also will benefit all farm lenders, agricultural producers and farm-related businesses.

Glossary of Credit Terminology

[From: Farm credit System Legislative Committee]

Basis point. 1/100th of one percent.

Current issue. The most recently auctioned issue.

Current maturity. Current time to maturity on an outstanding note, bond or other instrument. For example, a five-year note one year after issue has a current maturity of four years.

Default. Failure to make timely payment of interest or principal on a debt security or to comply with the provisions of a bond indenture.

Discount securities. Non-interest-bearing money market instruments that are issued at a discount and redeemed at maturity at full face value.

Discount window. A facility provided by the Federal Reserve enabling its member banks to borrow reserves against collateral in the form of governments or other acceptable paper.

Government Securities called "Governments" or "Treasuries". Negotiable U.S. Treasury securities.

High-risk loan. Loan that is 90 days or more past due but is adequately secured by collateral.

Losses. Loans that have been "written off" or "charged off."

Non-accrual loan. Loan on which interest is not being accrued on a bank's books because the loan has been past due for a specified period of time; placing a loan in non-accrual status does not relieve the borrower from his responsibility to pay interest.

Non-performing loan. Loan on which the borrower has not met payments.

Paper. Money market instruments, commercial paper and other.

Performing loan. Loan that is current and meets all terms, conditions and contractual obligations.

Recoveries. Loans that have been written off or charged off but later paid back or recovered.

Restructured loan. Loan that has been amended to incorporate concessions made to borrower for economic or legal reasons.

Spread. Difference between bid and asked prices on a security; difference between yields on two securities of like maturity from different issuers, or difference between price realized by the issuer and price paid by the investor.

Uncollectible loan. Efforts to collect the loan have been unsuccessful; however, there still may be subsequent recovery value.

Write-off/Charge-off. Marking down on the books to recoverable value any loan that is distressed. Loans are written down by charging the allowance for loan losses. If the allowance is insufficient, the write-off directly affects earnings.

[The following information was submitted by Frank Naylor Undersecretary for Small Community and Rural Development, USDA]

Summary of the Administration's Position on the Farm Credit System

The Administration is in the process of an intensive Administration-wide review of the operating conditions, strengths and weaknesses of the operating Farm Credit System. As part of this review, extensive discussions have been conducted with representatives of the operating system, their independent accountants Price-Waterhouse, and the Governor and the senior staff of the Farm Credit Administration.

While the issues and problems faced by the Farm Credit System are unusually complex and varied, it is the Administration's view that the system's projections of the necessity of reporting substantial losses during the next two years in the magnitude of $2.5 billion from the fourth quarter of the current year and $1-1/2 billion for each of the next two years is based on reasonable prudent economic assumptions. Based on the assumption made by the operating system and its accountants, the system, after taking the appropriate steps to reserve and manage its problem loans, should return to a positive operating position in 1988.

The operating system, including its associations, continues to have a very strong financial balance sheet. As of September 30, it has loan loss reserves totaling some $1.6 billion, earned net worth of $5.5 billion and member stock totaling $5.3 billion. This $12.4 billion in funds, coupled with a high percentage of loans which continue to perform adequately, provides the capacity and the potential in our view for the system to be able to effectively work in its own behalf to remain an effective and viable lender if provided with the necessary tools to do so.

Therefore, the Administration proposes:

First, creating authority for an internal Farm Credit System entity that would mobilize the system's earned surplus in order to absorb operating losses and manage troubled loan assets.

Second, restructuring the Farm Credit Administration into a true arm's length financial regulator whose authorities would include matters of entry and exit, capital, safety and soundness, and enforcement of supervisory directives.

If Congress is willing to legislate both (1) the self-help changes that will enable FCS to tap its own considerable resources, and (2) the reform of FCA into an independent supervisor, the Administration will assess the need for Federal financial assistance.

We believe the best mechanism for handling the System's bad asset problem is to permit the Farm Credit System's Capital Corporation (FCSCC), established under the FCS, to:

a) acquire from financially troubled System institutions loans and property at no greater than market value;
b) assume or issue obligations, that would be jointly and severally guaranteed by the FCS, so as to carry the assets while they are being held, leased, or restructured in an orderly fashion;
c) obtain earned surplus from those operating units which have it and transfer it to those which are in deficit; and
d) assess the operating units to capture sufficient future earnings as support for FCSCC's debt service obligations and operating losses, subject to existing FCA regulations to transfer capital.

We believe the best mechanism for ensuring a permanent solution to the System's operating problem is to provide a strong and effective financial regulatory agency with authority broadly similar to the regulating nonfarm financial institutions.

The reformed regulatory authority should be provided with general powers that include:

a) restructuring of present management board with a single Chairman appointed by the President and confirmed by the Senate;
b) general rulemaking authority and examination and enforcement powers;
c) power over exit and entry to the system, including approval and/or requiring mergers; and
d) authority to establish capital requirements and safety and soundness provisions.

The Administration is convinced that the actions I have just outlined will assure a steady supply of available credit for farmers and ranchers at reasonable rates. Further, these actions will help stabilize declining land values by assuring that precipitous liquidation of land loans can be avoided. This stability in rural credit markets will assist all farm borrowers, even those who are not participants in the Farm Credit System.

In addition, it should be remembered that FmHA loan guarantees are available to qualified farm credit borrowers and that most farm credit associations are FmHA approved lenders.

NOVEMBER 1, 1985 HEARING

STATEMENT OF HON. EDWARD ZORINSKY
A U.S. SENATOR FROM NEBRASKA

Mr. Chairman, I welcome these hearings on the Farm Credit System. The farmers in my state of Nebraska have asked many questions this past year, and as borrower-members of the system, I think it is about time that they get their questions answered. As we finish the 1985 farm bill, we need to address the farm credit dilemma as soon as humanly possible. There simply is no more time for further delay in analyzing where we are and where we are going with the Farm Credit System.

Farmers are finding that borrowing money has become an increasingly frustrating experience as their own financial position continues to erode, and the overall U.S. agricultural economy continues to deteriorate. Farmers have lost over $200 billion of equity in their operations during the past four years. Farmland values have declined 25 percent nationwide since 1980. With prospects of lower loan rates in the 1985 farm bill and another four years of surpluse production, farm commodity prices will continue to be depressed and farmers can look forward to further credit problems.

Yesterday we heard testimony from the Farm Credit System, the Farm Credit Administration, and the USDA. I think today's testimony will be even more enlightening.

I look forward to this hearing, especially the comments of the farmer-borrowers of the Farm Credit System institutions who are the ones most affected by the System's problems.

Thank you, Mr. Chairman.

STATEMENT OF HON. MITCH McCONNELL
A U.S. SENATOR FROM KENTUCKY

Yesterday, testimony revealed alternatives to get out of this Farm Credit System mess. I must candidly admit, however, that this Senator is not convinced that the Farm Credit system has the management structure in place to facilitate the changes which must be made to strengthen the administrative management of the System. Nonetheless, it was encouraging that Farm Credit officials admitted publicly that the System would need help, even if it was about 8 months too late.

I listened with interest to the statements of the Senator from Minnesota yesterday. I wholeheartedly agree with Senator Boschwitz that the single best thing we could do for farmers immediately is to develop a plan to reduce interest rates. There are a variety of ways to do this, but I hope this Committee will give this option its utmost consideration. Yes, interest rate buy-down is a short term fix. But, Mr. Chairman, a short term fix is needed in this case to stop the bleeding before the patient bleeds to death. In addition, maybe it will give more time for the agricultural experts in the Treasury Department and the White House to recognize the depths of the farm credit crisis.

Yesterday, we heard management's stories. Today, we'll hear farmers' stories, and I have no doubt that we'll hear fewer excuses for the way the situation has deteriorated. Instead, I expect we'll hear the same kind of stories that I mentioned yesterday in my opening statements. I really don't thing Kentucky farmers are that much different from farmers in other parts of the country and the stories of Farm Credit System Directors and borrowers are frightening. Aside from the financial problems of the institution, the Farm Credit System has some severe public relations and credibility problems which will not go away. I hope today's witnesses will send a strong signal to Governor Wilkinson and his brethren at the Farm Credit System that System borrowers and Directors are tired of being accused of being the problem.

Mr. Chairman, I ask unanimous consent that a statement by Roger Sledd, a Kentuckian who represents a group of Farm Credit System borrowers in the 4th Credit District, be included in the record at this point.

Thank you Mr. Chairman.

STATEMENT OF ROGER B. SLEDD, REPRESENTING DIRECTORS AND STOCKHOLDERS, FOURTH DISTRICT ASSOCIATIONS

Mr. Chairman, and members of the subcommittee, I am here on behalf of directors and stockholders of the Fourth District Associations concerned about misrepresentations, coercion, and intimidation that has been exerted on the directors of the associations of the Fourth District to compel them to vote for the consolidation of associations into one joint managed land bank and one production credit association in Louisville, Kentucky.

At a recent meeting in Paducah, Kentucky, 55 directors favored the 28 joint-association plan, 4 favored the 1 PCA and 1 FLBA association plan, and 4 did not vote for either plan.

I cite these numbers to show how compelling the opposition is to the one association plan among the directors of the associations.

It is not our intention to oppose or minimize the need for help that exists in the Farm Credit System. Rather, Mr. Chairman, we are here to ask you and the members of this Committee to use your oversight authority and influence to require the Fourth District in Louisville, Kentucky, to withdraw the consolidation plan that has never been formally presented to the stockholders of the associations and either permit the stockholders to vote on the association plan as originally proposed or amend the statutes make clear that the associations can be consolidated and unified in the manner and form presently being attempted.

Under no circumstances should the plan be permitted to be submitted to the stockholders under the air of intimidation and misrepresentations that currently prevail. To permit this vote and the further dilution of control and input from the local borrowers/stockholders will have major consequences on the efforts to stabilize and maintain the Farm Credit System, in our opinion.

The increase in interest rates in the Fourth District is a burden that the farmer/borrower cannot shoulder and has had the consequence to drive the good loans out of the system.

In January 1985, there were 4.7 billion in loans outstanding in the Forth District, on September 30, 1985 there were 4.2 billion in loans outstanding, a loss of 538 million in outstanding loans which in large measure was caused by the ill-advised interest rate increase. the impact of this pay down in loans can only be estimated. It is clear that only credit-worthy loans attractive to other institutions have been lost at lower rates. Not only did the system lose the good loans but accruing interest at 13.25 percent or an effective 14.00 per cent rate when the farmer is operating in an agricultural economy that does not even return production costs in engaging in self-deception and mismanagement in its highest form. Put simply, the Fourth District may accrue interest at 14.00 percent but the borrower/stockholder cannot pay it.

As you well know, Mr. Chairman, the farmer today is in a critical situation brought on by a strong dollar that has encouraged imports of cheaper farm products, and discouraged the export of American farm products. A period of deflation which encouraged borrowing and expansion by well-intentioned farmers attempting to protect themselves from the inflation, and a policy of free markets with a overcapacity of production that seems to be limited only by the American farmer's imagination and capacity for output. Specially, whether we agree or disagree with the present agricultural policies or those that preceded them, the american farmer today is dealing with a situation that good management and better production efforts cannot solve, at least in the short term.

In the last eight months, I have seen the over production of grapes in the Napa Valley, the devastation of the citrus crop in Central Florida from two years of successive freezes, the great depression in the grain belt and the loss of real income in the tobacco producing states. Sir, the present agricultural crisis is not confined to any geographical area and represents the most compelling and critical need in our country today. The fallout from the absolute collapse of the agricultural sector of the economy, which includes the Farm Credit System, will have devastating consequences on land values, tax bases of state and local governments, and the collapse of our financial institutions, not to mention the human suffering and costs.

There are no easily solutions, the alternatives at best are not without serious consequences, but the delay will only make more expensive the remedies and input that must ultimately be provided.

First: Local control of the Farm Credit System must be maintained and strengthened by requiring the continuance of the election of the local boards by the borrower/stockholders.

Second: A change in the method of electing the District Bank Boards to reflect the true representation of the Board by those who own it and not those who use it. Specifically, the borrower/stockholders should elect the boards of directors of the District Banks in proportion to their contribution of assets to the District Bank on an annual basis.

The hard-headed conservation control of those who own the system will tighten the controls and require the system management to provide a workout and management of existing loans on the local level.

The erection of expensive buildings on the District Bank level filled with overpaid managers mumbling about the plan of 1995, has no place today. The large corporations have no interest in operating businesses that cannot get a profit to the bottom line.

Third: Define a clear line of demarcation between the management and regulation of the system on the national level. The model of the F.D.I.C would be a start in terms of separating the functions of the Farm Credit Administration and insuring that the regulator is not also the manager of the system. This has caused excesses and abuses which have loosened the control needed to insure the continuance of the system. There is need for strong national regulation of the system, but in our opinion we have asked too much of the present FCA and we need to define and limit the control of the FCA management function, and look to the local borrower/stockholders boards on the local and district level for authority and responsibility.

Fourth: The focus of this Committee should be to help the Farm Credit System, the needs of commercial banks, insurance companies and other lenders are a part of the total package, however, the Farm Credit System can be helped by specifically looking to the 1933 Emergency Farm Mortgage Act. The advantage of that act is, (1) it has precedence; (2) it worked; and (3) it is comprehensive in its approach.

Specifically, buy down interest rates defer principal payments write down a portion of the debt in exchange for a portion of the debt in exchange for a promise to make future payments.

The cost of this proposal cannot be estimated without more and better numbers from the FCA, however, there is one thing I am absolutely sure of, the failure to act forthrightly, courageously, and soon, will only increase the cost of saving the major component of agricultural lending, a system that ultimately cannot be permitted to fail without the most serious of consequences to all Americans, not just the farmers.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM ILLINOIS

Mr. Chairman, I again want to commend you for holding a second day of hearings in the Senate Agriculture committee on the Farm Credit System.

Yesterday we received testimony from the Farm Credit Administration, the Farm Credit Council and the Department of Agriculture. I am pleased that the Committee is holding this second day of hearings to allow representatives of a number of different groups, both agriculture and banking, to testify. It is vital, as the Senate looks to remedy the present farm credit crisis, that we solicit advice and assistance from interested parties.

This morning, Mr. Chairman, I have the pleasure, of presenting to the Senate Agriculture Committee my longtime friend, the distinguished Attorney General of my home State of Illinois, Neil Hartigan. He has looked long and hard at the problems which face the farmers and bankers of Illinois and across the Nation. His presence here in Washington demonstrates his sincere interest in this issue and his strong believe that we must maintain both the viability of American agriculture and the strength of our Farm Credit System and our commercial banks. I look forward to his testimony and urge my colleagues to listen with care as Attorney General Hartigan testifies.

Thank you, Mr. Chairman.

[The following material was submitted by Senator Boren.]

SENATE AGRICULTURE HEARINGS, OKLAHOMA CITY, OK

Wednesday, September 25, 1985

STATEMENT OF ORIS O. TAYLOR, GUTHRIE, OK

There can be volumes written on the farm credit problem. I have worked on financing farming all of my life. Today's problem has been brought about by (a) investors buying loan for speculation which caused prices to rise (b) Farmers in effort to compete buying land in a speculative market and not on agriculture basis (c) The rise in interest rates followed by fall in market price.

There are some things that caused these problems to be more severe.

1. The Farm Credit system cased to function as a agriculture lender and become a short time lender. This is to say in the struggle to increase their profits, to have higher salaries for employees, and to have employees better housed and better educated -- they (the administrators) forget they were an agricultural lender and completely lost sight of their mission. All this was aided by elected Board of Directors on both District and Regional levels that forgot what could happen and what had happened in the past, and allowed our system of credit change to that of a commercial bank. No one on the farm today will ever forget what is happening in

agriculture today and certainly not those of us who are left that was a part of the 30's.

2. Another factor that has caused this credit problem to be more severe was the increase of salaries encouraged building of new and bigger office facilities throughout the industry. Today this money would help to hold the line on a few more foreclosures.
3. There has been an increase in administrative expense because of more paper work; more reports to be made and closer inspections on all levels of lending. This has not helped the farmer solve this problem, but has added 25% to 50% to the administrative cost on both Regional and District levels.

There are farmers today whose actual farming operation has not changed in the past three to five years. Yet due to using current market prices on land, machinery and some on cattle, they are being foreclosed. These people need more credit consideration. In some instances these persons were yesterday's buyers at the encouragement of some loan officer. Now they are being put out of business.

Attention must be given to the following:

1. There must be an effective, intelligent and local input into agricultural loans. this can only be accomplished by local loan boards.
2. There must be a restriction of lending to full time farmers. (What is a full time farmer?)*
3. There must be a greater reserve developed and restrictions that will not allow administrators to drain this off in salaries and physical plants.
4. There should be provisions made to serve agri-business as they are a part of agriculture -- more so today than ever.
5. There needs to be a provision to "turn over" capital investment from agriculture bonds without tax penalty. This is similar to tax shelter, and retirement funds used by other persons today.

As Senator Boren knows I have worked with this problem even before it became a problem. The issue at that time was whether Local Boards had any authority on making and maintaining loans. We lost because a law had been passed to give this authority to persons in Washington. As the local person lost authority, the philosophy of lending changed from agriculture oriented to a Commercial Bank type operation. He who has the Gold makes the rule. This is the Golden Rule of today, yesterday, and will be tomorrow. There is a way where Regional Boards come to be more responsible to obtain money and not be controlled by Farm Credit in Washington.

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* A "Full Time Farmer" or "Professional Farmer" or whatever you choose to call the position, would need to be defined on such factors as percentage of time devoted to farming, where they reside, and percentage of income from farming. This would in effect give a license to participate in better rate interest loans in capital investment items such as land and equipment. Other persons who wanted to farm would be required to do so for a limited time before qualifying for low interest loans.

I work with land owners in Oklahoma, Texas, New Mexico and Arkansas. I see so many farms that have been in the family for 80 to 100 plus years that are at this time facing liquidation because of low appraised value of land and equipment based upon market value of land equipment at an auction. These owners have not intended to sell. If given longer credit they will recover, pay their debts and continue being the backbone of their community and of America.

STATEMENT OF HON. DON NICKLES
A U.S. SENATOR FROM OKLAHOMA

I wish to express my appreciation to Senator Boren for having the opportunity to submit this statement since I will be unable to attend due to a scheduling conflict. Let me first commend Senator Boren for his leadership on this and other agriculture issues. I am pleased to be able to work with him on agricultural concerns.

On August 28th in my Oklahoma City office, I gathered together approximately twenty-five farm credit regulators, lenders and borrowers for a private and frank discussion. It was one of the most informative meetings I have ever held and would like to offer some of the input received at the meeting.

One theme was clear. If farmers were able to make a profit rather than suffer under low commodity prices, we would likely not have a farm credit crisis. Increased farm profitability is the goal I have had in promoting farm bill changes which would allow farmers to maximize program benefits while producing on fewer acres.

Proposal I outlined at the first Senate farm bill hearing in March served as the basis for the most substantial change from the previous program written into the Senate farm bill. As an example of the proposal's profit potential, under the Senate bill, an Oklahoma wheat farmers could receive a target price equivalent of up to $6.10 per bushel on the production from forty percent of his acreage. I commend Senator Boren for his successful effort to incorporate this change and other improvements into the committee farm bill.

At last months farm credit meeting, we also discussed the financial positions of agriculture lending institutions. A representative of the Federal Reserve indicated the financial position of Oklahoma banks was better than three neighboring farm states but not as good as two others. He indicated seven and one-half percent of all agriculture banks were considered problem banks, but in no state were over ten percent of the banks considered problem banks. Farm Credit Bank of Wichita officials indicated our farm credit district's financial position ranks in the meddle of all farm credit districts. Ten percent of Federal Lank Bank loan are non-performing while 6.2 percent of Production Credit Association loans are non performing. The state director of the Farmers Home Administration reported the delinquency rate on farm loans was down to 23 percent from 33 percent in 1984.

There is no doubt that we have farm credit problems in Oklahoma. My concern is how do we halt the economic slide agriculture has been experiencing? How do we keep farm interest rates from escalating despite drops in the prime rate? I believe the farm bill changes I previously mentioned will increase the opportunity for farmers to produce profitably.

On August 1, prior to the Farm Credit Administration's appeal for federal assistance, I introduced a bill with Senator Boren which set forth proposals to lower farm interest rates by guaranteeing and making tax-exempt bonds issued by the Farm Credit System. The proposals could lower the Farm Credit System's cost of raising money to lend to farmers by thirty percent and would shore up investor confidence in the system's securities. This bill, S. 1565, would give us the facts about government guaranteed tax-free Farm Credit System bonds.

Something is wrong when agriculture has to pay more for money when the rest of the economy is paying less. Since September of last year, the prime rate has dropped from 13 percent to 9.5 percent, a 27 percent decline. But look what has happened to farmers' cost of money during this time. Oklahoma Federal Land Bank borrowers saw interest rates jump from 11.75 percent to 12.5 percent on January 1 of this year. Today some borrowers are paying up to 13.75 percent. When the Farm Credit System takes a loss on a loan, this cost is not coming out of some investor's pocket. It comes in the form of higher interest rates to those who can least afford it--farmer and ranch borrowers.

I don't propose that providing government-backed or tax-free FCS bonds is the answer to all of agriculture's problems. However, I do think the prospect of lowering farmer's interest rates through the measures I have outlined are worth pursuing.

Additionally, I hope the positive farm program changes Senator Boren and I made in the Senate, are incorporated into the final bill. Farmers need the opportunity to make a profit and the ability to diversify without risking reduction in their acreage base. That is exactly what our program changes offer.

In closing, let me say there is indeed a crisis in agriculture. No single piece of legislation will solve all of our problems. But collectively, congressional actions can improve the industries economic climate. Through commodity programs, we are addressing the income side of the equation. Through farm credit proposals such as those I have outlined today, we can take steps toward reducing the interest expense which is eating away profits for much of the nation's agriculture sector.

Again, I appreciate the opportunity to have this statement presented and commend Senator Boren for his initiative to examine the farm credit problems facing Oklahoma farmers and ranchers.

STATEMENT OF GEORGE A. MEACHAM
CLINTON, OKLAHOMA, CHAIRMAN OF THE BOARD
FARM CREDIT BANKS OF WICHITA

Senator, I am George A. Meacham, a farmer-rancher from Clinton, Oklahoma and the chairman of the board of the Farm Credit Banks of Wichita. I am pleased to provide testimony today on behalf of the Farm Credit Council and the Ninth Farm Credit District, which includes Oklahoma, Kansas, Colorado and New Mexico. I will address credit conditions within the Farm Credit System nationwide and discuss actions we are taking to deal with today's farm income crisis.

The farmer-owned Farm Credit System includes Federal Land Banks, making long-term real estate loans through Federal Land Bank Associations (FLBAs); Federal Intermediate Credit Banks, which discount notes of Production Credit Associations (PCAs), providing short-term operating loans; and Banks for Cooperatives, which finance farmer-owned cooperative businesses. The Farm Credit System has been a reliable source of short-, intermediate- and long-term credit for agriculture for decades. The various parts of the cooperative Farm Credit System were authorized by Congress over a 17-year period -- 1916 to 1933 -- to meet unique needs of farmers, ranchers, and their cooperatives.

These various entitles of the Farm Credit System were originally capitalized with government seed money, which has since been entirely repaid. During the 1930s, the government again provided capital, but this capital along with the original seed money was fully repaid by the end of 1968.

The land banks and their affiliated associations were created under the Federal Farm Loan Act of 1916, because farmers had an urgent need for more and better long-term mortgage financing.

Congress established the Federal Intermediate Credit Banks in 1923 with the Agricultural Credits Act. Federal Intermediate Credit Banks act as wholesalers of funds from investment centers, recognizing farmers' and ranchers' needs for short- and intermediate-term operating credit. The intermediate credit banks were authorized to discount farmers' notes for commercial banks, agricultural credit corporations, and livestock loan companies. They were also authorized to make credit available to cooperatives, but only on farm products they held in storage.

During the Great Depression, climaxing in 1933, the government came to the assistance of the land banks, along with many other financial and business organizations. At the same time, the Production Credit Associations and the Banks for Cooperatives were organized under the Farm Credit Act of 1933. By this time, even the inadequate supply of short-term credit supplied by commercial banks, merchants, dealers and individuals had dried up and PCAs were formed to meet this need.

No financial institution can separate itself from the fortunes of its customers. The Farm Credit System, which has 100 percent of its assets in agriculture, is being directly affected by the deteriorating farm economy.

Today, many experts are comparing the current agricultural business environment with that of the Great Depression. While there are many structural differences between the economy of today and the economy of the 1930s, the fact of financial stress is the same. The current financial position of the Farm Credit System reflects the severe impact of the depressed agricultural economy. Loan losses, non-accrual loans and property acquired through foreclosure have continued to increase, while loan volume has declined. Based on our current projections and economic indicators, the negative trends in credit quality and non-earning assets are expected to continue for the near future.

Substantially higher loan losses, increased non-earning assets and loss sharing agreements within the System are projected to end in a fiscal 1985 year end loss.

Restructuring Plan

The current difficult circumstances make it all the more important that the proposed restructuring plan be adopted for the Ninth Farm Credit District. Our board of directors reviewed all possible alternatives for dealing with the deteriorating farm economy, and we chose the one course of action which offers the best change for continuing viability. It is unanimously supported by the farmers and ranchers who serve on our board.

The proposal will consolidate our 37 Federal Land Bank Associations into a single district wide FLBA and our 34 Production Credit Associations into a single Districtwide FCA. Bank and Association management will be integrated and consolidated.

Full service, one-stop Farm Credit Centers will be operated in every one of the 974 communities now served by a full-time PCA or FLBA office, under the initial proposal. Duplicate offices in the same town will be closed, wherever possible, in order to cut costs.

Farmers and ranchers will be able to go to the same community where they now receive service, or to any Farm Credit Center which they choose. All of their credit needs, both short- and long-term, will be handled by a single loan officer. Loan approval authority will be delegated to local Farm Credit Centers to help provide faster and better service.

It is important to note that the specifics of the restructuring proposal were developed by 8 different work groups composed of farmer/rancher directors, local Association officers, and Bank Staff. People in the field were deeply involved in developing the organizational structure of the new Associations.

The restructuring will cut costs, achieve efficiencies, pool capital and streamline service to borrowers. These actions are essential to demonstrate that we are acting responsibly to deal with our problems internally to the maximum extent of our resources.

Farmer Control

More than any other single issue, the question of farmer control has been most misunderstood in regard to our restructuring plan. The plain truth is, farmer/borrower control must be and will be maintained under our restructuring -- but it will be structured differently than what it is today.

Farmer/rancher borrowers will continue to elect representatives to serve on the Ninth Farm Credit District Board. They will continue to elect farmer/rancher representatives on the boards of the FLBA and PCA -- in fact, these farmers and ranchers will have considerably more responsibility than the current Association boards, because they will be responsible for the entire four states.

Under the restructuring plan, there will be a 15 member Districtwide Advisory Committee, with representatives of every region of our four-state district. Beyond that, there will be farmer/rancher Advisory Boards for each of the 15 administrative centers across our district.

As you can see, farmers and ranchers elected by Farm Credit stockholders will continue to provide leadership for the Farm Credit System. Local service and grass roots input will continue.

Keep in mind that the role of boards of directors is to review the facts objectively and then make a decision, based on those facts. If the facts do not change, then the outcome of the decision should not change, whether the number of directors making that decision is 7 or 70.

It is true, however, that there is a threat to farmer control of the Farm Credit system -- and that threat comes from government regulators in Washington, D.C. The Farm Credit Administration, our government regulatory agency, is seeking to substantially increase its regulatory powers. FCA has already proposed emergency regulations which would empower them to unilaterally withdraw funds from district banks, as necessary. Legislation to further beef up FCA powers is pending in Congress.

We recognize that FCA is seeking these powers so that capital can be moved to the areas of greatest need. We believe, however, that farmers and ranchers should take the action -- and that responsibility -- on ourselves. We should move practively to approve the restructuring plan, so control will remain in the hands of farmers, rather than government bureaucrats.

Federal financial Assistance

Last week, I and our board members met with the farmers and ranchers who serve on the boards of directors of all of the Nation's 37 Farm Credit Banks. All of the Boards reached consensus that in light of the depressed condition in U.S. agriculture and the projected deterioration in the farm economy, the Farm Credit System will likely require Federal financial assistance to ensure the continued viability of the System as a provider of credit and related services to U.S. agriculture. Without Federal assistance, the interest rates which we would have to charge to our farmer, rancher and cooperative borrowers would be intolerable.

Further, the boards of the System banks agreed to authorize a special six-man legislative committee to act on behalf of System institutions in seeking such Federal assistance. This committee will be authorized to make decisions for the System regarding the timing, amount and form of any such assistance. The assembled directors also reached consensus that in seeking Federal assistance, the legislative committee will be subject to oversight by the newly chartered Farm Credit Corporation of America, whose directors represent each of the 12 Farm Credit Districts and the Central Bank for Cooperatives. It will be guided by the following principles:

1. Assistance should be for the minimum amount necessary and of the shortest duration possible to enable the System to continue to perform it congressionally mandated mission.
2. Levels of assistance must be sufficient to strengthen borrower confidence and ensure full and timely payment of principal and interest to holders of System securities.
3. Farmer/borrower control of the System should be maintained.
4. Government involvement in the System decision-making process should be minimal.
5. Extension and administration of credit should not be politicized.
6. Except for ongoing regulatory supervision, the government's involvement with the System should end with the expiration of any assistance package.
7. Expanded lending authorities are not contemplated.
8. The System should not be mandated to assume any of the lending activities now held by government agencies.
9. Significant structural changes for System institutions required as a condition for financial assistance must be approved by the Farm Credit Corporation of America's board.
10. The System recognizes the need for a strong and independent Federal regulator and will support statutory changes to give the Farm Credit Administration powers similar to those held by other financial regulatory institutions, while also reducing the involvement of the Farm Credit Administration in the management of the banks.

Financial condition of the Farm Credit System

While Federal financial assistance is likely to be needed to ensure against irreparable damage to our credit delivery system, which is of vital significance to U.S. agriculture and the Nation's economy, the Farm Credit System continues to have substantial resources. Looking at the overall financial condition of the Farm Credit System as of June 30, 1985, the System had $745 million in loan loss reserves, as well as capital of $5 billion and surplus of $4.2 billion, for total capital of $9.2 billion. Net loans outstanding of the Farm Credit System were $74 billion on June 30, 1985, a decrease of $1.8 billion, or 2.4 percent, from the amount outstanding at March 31, 1985, and a decrease of $3.1 billion, or 4 percent, from December 31, 1984.

Because of the continuing deterioration in the agricultural economy, it is not possible to accurately forecast exactly how much of the system's total loans outstanding may not be collectible. However, I would like to point out the inaccuracy of recently published reports which stated that 15 percent of the System's total $74 billion in loans is "uncollectible."

As of June 30, 1985, the Farm Credit System had approximately $2 billion non-accrual loans, or less than 3 percent of total loans outstanding. Non-accrual loans are those on which interest is no longer being accrued because collectibility of future interest is uncertain. Non-accrual loans represent non-earning assets. However, this does not mean the total value of the loan will be lost, because there is collateral pledged against the loan.

A key distinction must be made between non-accrual loans and the rest of a general category called "problem loan". The category of problem loans includes non-accrual loans, but it also includes other loans which are still earning interest and are either current as to principal and interest payments or, if past due, are adequately secured. Loans in this category include those loans which require more than normal servicing, and those classified as other high risk loans.

As of June 30, 1985, restructured and high risk loans of the Farm Credit Banks amounted to $7.8 billion. However, as a result of the deteriorating farm economy, loans classified as requiring special servicing and other high risk loans are expected to increase by as much as $6 billion for September 30, 1985.

Forebearance for farmers

The Wichita District and the Farm Credit System are committed to fulfilling the responsibilities assigned to us by Congress. These responsibilities include the Congressional mandate to provide sound, adequate and constructive credit to American farmers and ranchers at the lowest cost, consistent with sound business practices. We also fully endorse and subscribe to the forebearance policy of the Federal Farm Credit Board, which commits us to remaining with distressed borrowers as long as there is reasonable prospect for their financial recovery and to avoid disclosure until there is no reasonable alternative course to action remaining.

Our policy is t consider forebearance when a farmer or rancher is being cooperative, doing his honest best to meet the conditions of the loan agreement, and is capable of working out of his debt situation. However, when there is no longer a reasonable change of recovery, we do neither the borrower in question nor his fellow stockholders any favor by placing the association in a position of greater losses which will eventually have to be covered by higher rates to other farmer-rancher borrowers.

Summary

Senator, I assure you that the Farm Credit System has and will continue to provide agricultural credit in a sound, businesslike manner. We have proposed a restructuring plan which will make necessary economic adjustments and improve efficiencies, while maintaining grass roots input from our farmer, rancher and cooperative borrowers. We are also realistic, and we understand we cannot control or guarantee the future of the farm economy. If current trends continue, Farm Credit system resources could be overburdened. Federal assistance will allow us to continue to offer competitive interest rate to our farmer, rancher and cooperative borrowers.

The bottom line is that farmers are not receiving sufficient income from their operations to service their debt. There are no likely prospects of farm legislation or macroeconomic trends which will turn this around.

Be assured we are taking appropriate actions, such as the Wichita District's restructuring and the decision to seek federal financial assistance, to deal with the farm income crisis and maintain the viability of the system, which is a vital link between Wall Street and the farmers and ranchers of America.

Senator, thank you for this opportunity.

STATEMENT OF DOUG TIPPENS, EXECUTIVE VICE PRESIDENT AMERICAN HERITAGE BANK, EL RENO, OKLAHOMA

Senator Boren, I appreciate the opportunity to appear today to discuss the farm credit crisis in Oklahoma and to present my views of the problems and possible solutions from the standpoint of a small community banker.

I'am an ag banker and a cattle and wheat farmer, raised in Western Oklahoma and received a B.S. Degree in Ag Econ from Oklahoma State University. Over 40 percent of my bank's loans are in agriculture. I think I have a good perspective on the farm crisis we're experiencing in Oklahoma and other farm states.

I can assure you the crisis in agriculture is not just affecting farmers. While farmers bear the direct burden of low commodity prices, decreasing export volumes, dropping land values, and high interest rates, agricultural lenders are also felling the pinch. Additionally, the crisis has trickled down to the businesses on main street . . . the implement dealers, the appliance store owners, the grocerymen, and the list goes on and on.

Unless this negative trend can be turned around and american agriculture made profitable again, people in the city will begin to feel the impact of the ag crisis.

The recognized movement towards a service-oriented industrial base, with fewer family farms and population shifts toward metropolitan areas is a 75 year old trend. In the inflationary '70's, the trend was disrupted as commodity prices soared and land values jumped. For a period of time agriculture looked profitable so lenders and farmers expanded their operations to capitalize on such a market.

But as we all know, when inflation slowed and commodity prices dropped, land values slumped and farmers were left holding over $200 billion in debt. The shakeout in agriculture and in rural America has resumed. Inevitably, many farmers will leave agriculture, therefore, businesses will close, and rural America will take on a new shape.

Congress has to soften the impact of this shakeout. It becomes a social problem when you talk about failure of the family farm, Ag lenders and businesses on main street and what to do with the mass of people that are dislocated. It's up to Congress to soften this crushing blow of current market conditions.

Only you can address the basic problem facing agricultural producers....the lack of income. I do not believe in trying to support these producers with continued government payments except to the extent that they have been damaged by a strong U.S. dollar, shrinking export markets due to the embargo and continued high interest rates.

Nearly 30 percent of Oklahoma's 532 banks are considered Ag banks. This means that 156 banks in the state have 25 percent or more of their loan portfolios in agricultural loans. I think we have a significant stake in the fate of agriculture in this state and as you know, the solution isn't easy.

Commercial bankers hold nearly 50 percent of the $2.7 billion in non-real estate farm loans in Oklahoma. Production Credit Associations and the Federal Intermediate Credit Bank hold 16 percent, while the FmHA holds 20 percent of the non-real estate debt farm debt. Ag real estate loans in Oklahoma total $2.7 billion, and the majority of which is held by the Federal Land Banks. The FmHA holds approximately 14 percent and Oklahoma banks hold 10 percent of farm real estate loans.

But regardless of the percentages held by each type of institution, I believe I can speak for all ag lenders when I say farmers need help. We have to move towards a supply and demand agriculture.

What's at issue is the type of assistance farmers should be given.

There are two proposals presently pending in Congress that will hurt the availability of agriculture credit. These measures, S. 744 and S. 1342, known at the "Clear Title Bill" and the "bankruptcy Bill" respectively, would reduce the farmers' chance to obtain credit in todays marketplace.

The "Clear Title Bill" could preempt the farm products exception to the buyer in the ordinary course of business section of the Uniform Commercial Code, and in effect, remove the lenders' protection on all collateral securing an ag loan. As you know, ag lending has traditionally been an asset based lending system as opposed to an income of cash flow based system. In ag lending we make a loan to buy a specific asset with repayment to come directly from the sale of that asset. In commercial lending where assets are bought guaranteed to be free of a lien, the marketplace has imposed a much higher standards. I do no think my ag borrowers can come up with enough margin to qualify under these stiff standards. Thanks for your leadership you have shown to seek a compromise on this issue.

The Bankruptcy Bill, if passed, would also have a negative impact on a farmer's ability to obtain credit. S. 1342 would allow substantially all farmers to file Chapter 13 bankruptcy, the bankruptcy section designed for consumers. Currently, most farmers who do file bankruptcy are filing Chapter 11 bankruptcies.

Chapter 11 bankruptcy allows the lender and the farmer to work together to develop a reorganization plan. Imposing the Chapter 13 alternative, where creditors are left out of the picture and the debtor would, in essence, be left to dictate the terms of the bankruptcy to the creditors, would certainly have an adverse impact on the availability of ag credit in the future. Ag lenders can not "take a chance" on the marginal producer as we once could because of this piece of legislation.

Our focus should turn to independence in agriculture and not spend our time and energy on legislation that will put the marginal farmers out of business. Bankruptcies are costly to lenders and these costs have to be passed on in the form of higher interest rates and higher service fees paid by all. Everyone agrees that income is the only way to put the farm sector back together.

The questions of income supports via deficiency payments, and production controls are complex. No one can predict what level is needed to keep a majority of farmers on the farm. But one thing is clear, doing what we have in the past, in my opinion, is not the answer.

Over the past 4 years, the farm program has cost us over $60 billion, yet we've had more farm foreclosures than at any time over the past 40 years. Income is almost half of what it was in 1970.

Why? Because the government's income support and production control programs are contradictory. On one hand, the government encourages farmers to grow surpluses while on the other it pushes supplies back down. The government has restricted output to compensate for the oversupply that artificially high prices would create.

I agree with the Reagan Administration's goal of getting government out of agriculture, but disagree with trying to do it overnight. In the future, market demands should dictate production levels. Then commodity prices will be determined by supply and demand levels rather than a four-year program of complexities and confusion.

We need a gradual reduction of the involvement of administrative agencies in agriculture. This involvement in agriculture extends beyond production controls and price supports. It includes direct and guaranteed funding by the farm bill's call for $4 billion in FmHA monies, $2 billion direct and $2 billion in guaranteed loan programs, during the 1987 fiscal year.

A gradual movement away from the direct lending to guaranteed lending is supported but don't entirely eliminate direct lending. 25 percent of all FmHA monies would always remain in the direct lending category to provide funding for those producers who can't qualify to obtain credit elsewhere.

For the guaranteed loan program to function properly, there needs to be a closer working relationship between FmHA county offices and private lenders. The success of the guaranteed loan program depends to a great degree on the FmHA personnel in each county. Senator Boren, I appreciate your efforts to speed FmHA response time on loan applications and reduce red tape at all levels.

Recent newspaper headlines and television reports have told us of the plight of the Farm Credit System. According to those reports, the System with it 37 district banks holds over $70 billion in ag loans and recent estimates indicate close to $11 billion of those loans may be uncollectible.

Farm Credit Administration Governor Donald Wilkinson has blamed a rapidly deteriorating farm economy for his sudden call for Federal Aid to bail out the system. I am extremely concerned with economic conditions down on the farm, and I'm also concerned about the condition of the Farm Credit system. But let us not forget that all agricultural lenders are being impacted, not just the land banks and the PCAs.

Many proposals are circulating in Washington on how to address the woes of the Farm Credit System.

One solution proposes that the bonds which are issued by the system be government guaranteed and possibly tax-exempt. Oklahoma's two Senators have asked that the Department of Agriculture analyze the proposal and its potential impact on the federal deficit.

Without the benefit of the USDA analysis that's to come, I can say with reasonable certainty that making the system's bonds tax-exempt is cost prohibitive. Conservative estimates indicate the tax-exempt bond proposal would cost the government billions of dollars a year at a time when we all should be working to trim the deficit. The idea of the federal government guaranteeing the system's bonds fine, but if you provide the advantage to the Farm Credit Banks you must guarantee equal access to those funds to all ag lenders, including commercial banks. Additionally, what about lenders to energy, timber industry, and others with financially stressed customers. Preferential treatment in favor of the Farm Credit Banks is unjust.

The crushing blow to the government guaranteed or tax-exempt bond idea is that it doesn't solve the system's current problems. All it does is allow the system to issue new bonds, bring in more money, and make more loans.

More money to lend to farmers doesn't solve the problem of loans not being repaid. That's not the answer to the problems of the Farm Credit System. The answer is providing farmers with a sufficient income so they can service their debt. Once that occurs, the pressure on the system and all ag lenders will be eased.

Farm Credit System officials are wanting to expand the powers of the Farm Credit Banks. In an internal study of the system's future labeled "PROJECT 1995" the Farm Credit System depicts the system as the future predominant provider of financial services to rural America. They see themselves becoming a gigantic nationalized bank holding company on the same level as Citicorp in New York City.

Senator Boren, I believe you recognize the dangers to our free enterprise system which would result from an agency of the federal government competing head-to-head with private purveyors of financial services. It would be the same as Oklahoma farmers having to compete with a nationalized corporate farm owned by the Federal government.

The Farm Credit System's cry for additional powers and authority to enter markets outside production agriculture should be studied carefully. If the Farm Credit System believes it needs to get into the commercial banking business because there is no longer a role for it in financing agriculture, then I suggest Congress carefully consider if there is any future for that agency.

When the Farm Credit System was created by Congress in the 1930's, there were very few institutions financing production agriculture. A legitimate need did exist.

The future of the Farm Credit System as projected in Project 1995 is not consistent with Congress' intent when it created the system. I urge Congress to reject Project 1995 and reiterate to FCS officials that their future belongs in agriculture lending, not in activities which would create a nationalized banking giant.

Any discussion of aid to the Farm Credit System must also focus on the competitive inequalities which could result. Any bailout proposal should be viewed with an eye towards the impact on other ag lenders and whether a bailout will give the Farm Credit Banks a significant advantage over these ag lenders. The Farm Credit amendment of the late '70's which allowed commercial banks to obtain funds from the Federal Intermediate Credit Bank was nothing more than putting the "fox in charge of the hen house". Our bank wanted to apply but was told that 29 out of 29 applications have been denied.

What will the impact have on the entire financial delivery system?

The farmers in this room are not concerned with the Farm Credit System or my bank's survival. They're concerned about enough income so they can survive.

To ensure the survival of all ag lenders we must first address the problems of providing farmers with the ability to earn an income. (Key Issue) Once they bring in more than they put out to produce America's food, the Farm Credit System and other lenders can cease to worry.

Congress must act swiftly to determine what shape the farm bill will take and what long range planning can be done in order to move towards a supply and demand agriculture. To have a farm bill as we have seen the past 4 years, will only insure the failure of many farmers because of our dependence on farm programs. I support the Boren-Boschwitz proposal and think it should be regarded as an alternative to free enterprise.

We've all been guilty of short-sightedness in the past. Short-range goals and short-range solutions have always been the easy way out. This time, however, Congress must develop and we all must support a farm policy that is consistent with the anticipated long-term economic conditions for American agriculture.

Senator, I commend you for your understanding, your compassion, your support, and your leadership. We must all seek common ground as we search for solutions to some of the most difficult questions of our time.

Thank you for opportunity to present my views today.

STATEMENT OF JOHN E. COCHRANE, STATE STATISTICAN
OKLAHOMA CITY, OK

Thank you for giving us the opportunity to participate in this meeting. My name is John Cochrane and I am here on behalf of Mr. Jack Craig, Commissioner of Agriculture for Oklahoma who was unable to attend today. My office, the Oklahoma Crop and Livestock Reporting Service is also a division of the Oklahoma State Department of Agriculture -- the division of Agriculture Statistics.

The financial plight of farmers has attracted unprecedented public attention as reflected in both the print and the broadcast media. Data was available to provide a reasonably good measure of the degree and distribution of financial stress at the national level, but only limited data are available at the state level. In order to provide industry leaders and policy makers a more adequate measure of the financial situation of Oklahoma farmers and ranchers, a survey has been conducted by the Oklahoma Department of Agriculture, The Oklahoma Crop and Livestock Reporting Service and the Department of Agriculture Economics at Oklahoma State University.

During late January 1985 mail questionnaires were sent to a sample of 2,610 farm and ranch operators. When the mail portion of survey was closed two weeks after the mailing, 539 responses had been received. A probability sample of 517 name was drawn from the list of non-respondents to the mail survey as a sample to be surveyed by telephone. A total of 254 schedules were completed from this list. After a careful editing process, 539 of the mail surveys and 254 of the telephone surveys, or a total of 793 responses were determined to be sufficiently complete and consistent to provide useful information, although some of these schedules were incomplete with respect to one or more items.

A copy of the survey results is attached to these comments.

The survey showed that 6 percent of the farmer respondents representing approximately 4,000 Oklahoma farms were in severe financial stress, facing financial failure in the immediate future. Another 14 percent representing approximately 10,000 Oklahoma farms were in significant financial stress having a debt-to-asset ratio ranging from between 40 to 70 percent. The remaining 80 percent of the farmer respondents representing approximately 57,000 Oklahoma farms indicated that they had either manageable debt or no debt. Forty seven percent of the respondents indicated they had no debt at all. The farm operators under extreme financial stress indicated that they rented approximately 65 percent of the total acres they operated, had on the average larger operations, and the operators tended to be younger than the average Oklahoma farmer.

Mr. Craig stated, "This looks like the tip of the iceberg". He believes that the farm financial situation during 1985 has worsened and as a result has requested that we continue to monitor the situation by conducting a farm lenders survey which we are in the process of doing now, attempting to access the farm financial situation as of mid-1985. He also plan to jointly conduct another farm financial survey of farmers themselves in February 1986 to continue to update the situation. The results of these surveys will be published as soon as they are summarized and will be made available to policy makers and all in agriculture who are interested.

Significantly contributing to the serious farm financial situation has been the decline in farmland values. The downward trend in farmland values that began in 1981 in mid-western states and in 1982 in Oklahoma accelerated during this past year. From April 1984 to April 1985 the farmland values in Oklahoma dropped 19 percent from a statewide average of $699.00 per acre in 1984 to an average of $566.00 per acre in 1985. Prospects for recovery in land values are clouded by continued high real interest rates, uncertainty over farm income, and the large number of arms being offered for sale.

I will be glad to answer any questions you may have.

THE OKLAHOMA FARM FINANCIAL SITUATION, 1984

(By John E. Cochrane, Marcia Tilley, Glen Knowles, and James S. Plaxico)

HIGHLIGHTS

80% of the farmer respondents indicated they had manageable debt or no debt.

47% had no debt at all.

14% were under significant financial stress.

6% were in severe financial stress (were facing financial failure in the immediate future).

High debt to asset ratios were associated with larger operations and younger operators.

Only 48% of the farmers said they were optimistic in 1984.

In order to provide industry leaders and policy makers a more adequate measure of the financial situation of Oklahoma farmers and ranchers, a survey was conducted by the Oklahoma Department of Agriculture, The Oklahoma Crop and Livestock Reporting Service, and the Department of Agricultural Economics at Oklahoma State University.

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The results

A basic objective of the financial survey was to determine the distribution of debt by age of the operator, location, and type of operation, and to determine how the debt is distributed with respect to the size of farm as measured by total assets and by gross income from sales. With the exception of limited questions regarding trends, the data relate to the calendar year 1984.

An Overview

A total of 556 respondents reported D/A ratios of 0.4 or less, with 324 of these farmers reporting no debt (Table 1). Thus 80 percent of the operators reported D/A ratios of 0.4 or less with 47 percent reporting no debt. On the other had 97 individuals or 14 percent of the respondents reported D/A ratios of 0.4-0.7, and 40 individuals or six percent of the total respondents reported D/A ratios of 0.7 or higher.

Although the D/A ratio that can be adequately supported by cash flow varies by type of farm and other factors, operations with D/A ratios greater than 0.4 are generally thought to be under significant financial stress given the current price-cost relationships. By the same token operations with D/A ratios greater than 0.7 are considered to be under extreme financial stress.

To the extent that the respondents to the survey are representative of farmers and ranchers in the State and the rough guidelines referred to above are relevant, one can conclude that about 20 percent, or one of each five of the farmers and ranchers in the State are carrying debt loads that threaten financial viability, with perhaps six percent facing financial failure in the immediate future. On the other hand, although few farmers and ranchers are prospering in the current environment, 80 percent of the operators have manageable debt loads.

The size of business as measured by total assets owned averaged about the same for the low and high D/A ratio groups averaged similar debt amounts. The average gross value of sales for 1984 was highest for the middle D/A group with the high group being a close second. However in terms of net cash income (the difference between cash income and cash expenses) the high D/A group reported an average negative income (loss) while the low ratio group reported the largest positive cash income. These data reflect the cost of debt service during 1984 given the relationship between commodity prices and interest rates.

In summary, operators with D/A ratios in the 0-0.4 range constituted 80 percent of the sample, owned 72 percent of the assets, owned 29 percent of the debt, received 56 percent of the gross and 91 percent of the cash income of the group. On the other hand the 0.7 and above D/A group were six percent of the farms, owned seven percent of the assets, owned 24 percent of the debt, held less than two percent of the net worth, received 14 percent of the gross income of the total and suffered a large operating loss during 1984.

It will be noted that high D/A ratios are associated with younger operators. Also the fact that gross income in the high D/A group relative to asset suggests that these operators rent a significant share of the assets they operate.

Crop Reporting District Means

Farmers in districts one and two (Northwest and West Central Oklahoma) reported the largest average off-farm income, perhaps reflecting oil and gas income. Respondents in the Panhandle reported the highest average D/A ratio and the lowest percent of farms with no debt. There appears to be no other major differences in the data by crop reporting district.

TABLE 1. Average Farm Financial Position by Debt/Asset Ratio

ITEM	DEBT/ASSET RATIO			
	<.4 Manageable Debt	.4-.7 Significant Financial Stress	>.7 Extreme Financial Stress	Statewide Total or Average
Number of Farms (in sample)	556 (80%)	97 (14%)	40 (6%)	693 (100%)
Age of Operator	60	50	46	58
		Average Per Farm		
Total Assets	$ 439,030	$ 636,054	$ 405,874	$ 466,842
Total Liabilities	37,860	341,277	340,830	102,885
Net Worth	400,091	294,777	65,044	361,667
Gross Farm Income	57,467	142,717	134,856	75,231
Net Farm Income	9,038	3,041	-11,985	6,773
Off-Farm Income	27,632	26,815	17,545	26,828
Debt/Asset Ratio	.07	.53	.87	.19
Acres Operated	922	1,658	2,157	1,112
Percent of Acres Rented	39.8%	50.4%	65.3%	45.4%
Farms with No Debt	324	0	0	324

Analysis by Gross Farm Income

Gross farm incomes of all respondents for 1984 averaged $75,231. Average net farm income for 1984 was $6,773. When the surveys were grouped by size as measured by gross farm income, 38 percent had less than $25,000 sales. This group of small farms accounted for only 21 percent of total assets and only 8.3 percent of total debt. Their average net farm income was negative (-$1,309).

In contrast, 48 percent of the farmers in the largest size category ($250,000 and higher sales) had debt/asset ratios greater than .4 and 13.6 percent had ratios greater than .7. The average debt/asset ratio for farmers in the largest size category was .38. Only 11.4 percent of the respondents in this group reported no debt. Only 7 percent of the respondents fell into this largest size category, however, these respondents accounted for 21 percent of total assets and 34 percent of total debt.

Overall, operations in the larger size categories tended to be more highly leveraged, to have a higher percentage of rented acres, to be much larger in terms of asset value and number of acres, and to have younger operators. Average operator age ranged from 59.3 years in the smallest sales group to 51.0 years in the largest group. Average acres operated ranged from 497 in the smallest size category to 4829 acres in the largest size category. Average liabilities ranged from $20,721 in the smallest size category to $495,300 in the largest size range. Net farm income ranged from -$1,309 in the smallest sales category to $25,708 in the largest category. Off-farm income appeared to be fairly evenly distributed across all size categories. It ranged from an average of $19,806 in the next to the smallest sales group to $31,644 in the largest sales group. Average off-farm income was higher than average net farm income for all sales categories.

Analysis by Type of Farm

Dairy farmers tended to have considerably higher debt to asset ratios than those found in the wheat, or cattle, or other categories (.42 as compared to a statewide average of .19). Only 18.2 percent of the dairy farmers reported no debt as opposed to 46.7 percent statewide. They also tended to have lower average off-farm income.

Cattle operations tended to be in the best financial position with average debt/asset ratios of .12 and average networth values of $415,211. However, cattle operations also experienced the lowest 1984 net farm income (-$1,489).

Opinions of Farmers

Surveyed farmers were also asked whether they were optimistic about farming, whether off-farm income was important to their farm operations, and whether debt payments were a problem for their cash flow. They were asked to respond as to how they felt in 1984 as well as how they remembered feeling in 1979 and 1974. Seventy-seven percent of the farmers said they were optimistic in 1974, 74 percent were optimistic in 1979 and only 48 percent said they were optimistic in 1984. Sixty-five percent said that off-farm income was important to their operation 1976, 66 percent said was important in 1979 and 69 percent said it was important in 1984. Approximately 26 percent of the respondents said debt payments were a problem in 1974 while 40 percent said they were a problem in 1984.

Respondents were also asked to express their views as to causes of the current financial problems which some farmers are facing and any adjustments they had made to the current financial situation. The most frequently cited cause of current financial problems was commodity prices. Input costs, interest rates and over-leveraged financial positions were also frequently cited. The least frequently cited reason was the budget deficit, although interest rates may be related to budget deficits. The most frequently cited adjustments involved decreasing costs of repairs and supplies and using older equipment. Other adjustments included decreasing acreage of number of livestock, working harder and decreasing hired labor, relying upon off-farm income, keeping debt to a minimum, altering of diversifying their operation, and emphasizing management. Twenty farmers said their adjustments had included partial or complete liquidation.

STATEMENT OF FRANK G. KLIEWER, JR., CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CORDELL NATIONAL BANK, CORDELL, OK

Senator Boren and Members of the Committee, I am Frank G. Kliewer, Jr., Chairman and Chief Executive Officer of the Cordell National Bank, Cordell, Oklahoma. I am past President of the Oklahoma Bankers Association, the Oklahoma State Chamber of Commerce, former Vice President and Member of the Board of Directors of the American Bankers Association. I was also a member of the executive Committee of the Community Bankers Division of the American Bankers Association which involves itself with banks of a $100,000,000.00 in assets or less. This encompasses over 10 thousand of the countries commercial banks. This division covers 90% of the agriculture banks, I'm also a member of the Oklahoma Industrial Finance Authority whose basic thrust is assisting industries in rural areas. I've given you this information not to pump my ego but to add credibility to the information that I'm entering in the congressional record from very concerned rural American businessmen, farmers, bankers, and politicians.

The rural American problem faced by the serious deterioration of our farm industry constitutes not only a large segment of the geographics of this country but an unbelievable number of people. There are over 3 million farm families totaling 12 million people with the direct responsibility of raising crops and livestock. There is an additional 40 million people in rural America -- main street businesses, processors, banks, school districts and court houses, which when added to the farm families total 52 million our nations society that live and breath with the fate of our farm economy. This group comprises more than 25% of our nations social and economic population. (That's a big bang which will have a disasterious effect on the other segments of our economy if not addressed.) Economic chaos is a certainty if the immediate impact of the farming industry is not recognized by our business leaders and those government officials both elected and appointed.

Recognition of the problem and realizing the seriousness of this emergency and acting as such will be the key to our survival.

Credit is not the only problem, although it is important. Human trauma resulting in premature death, some by stress, some self inflicted.

International trade should allow the farming industry the same "level playing field" in marketing their products as their foreign counter parts.

Lending agencies must also consider revolutionary restructuring of loans in its portfolio with thoughts to maturities, interest rates, weather and the general economic conditions.

Guaranteed loans thru the various government agencies are very helpful and mandatory in lengthening maturities of bank agriculture loans. They help maintain the banks liquidity, as you can sell the guaranteed portion on the secondary market. Thus retaining a flow of funds not only for further agriculture needs but for other business related needs of the local economy. The sale of the guaranteed portion of the loan taps markets with surplus funds of investible cash.

We as lenders must realize that integrity and character ("guts") are a key part of a borrowers ability and willingness to repay their obligations. The regulators must recognize this attribute in their examinations of the various lending institutions during these stressful times. In my opinion they are as important or "maybe so" than cash flow, collateral and net worth. We should try to understand that in this period of emergency, (the next 4 to 6 years), the personal background of the farm customer or agriculture related customer will normally help a fair credit become a good credit.

I had rather sit on a mount of "fire ants" than be a part of any group for the next few years in not recognizing and working for a solution of this serious economic problem facing agriculture. Which if not solved in my estimation could shake the very economic and social foundation of this great country. Yes, the materialist segment of this country known as the "yppies" will really learn how the other half lives.

If constructive leadership and legislation are not forthcoming, we will start slipping into a depression that will "snowball" to a point that will make the 1930's look like a Sunday school picnic.

In closing, in my opinion, if I were a person of influence I would rather not be labeled as part of the cause, but it would be most important that my actions make it "loud and clear" that I am a part of the care, and by caring I am a part of the cure.

Thank you!!!!!

STATEMENT OF HON. MAX BAUCUS
A U.S. SENATOR FROM MONTANA

Mr. Chairman, I want to congratulate you and your colleagues for finding the time to hold these hearings this week even with action on the farm bill. I know you have a great many witnesses, and I don't want to take such of this Committee's time.

Each of you knows as well as I the terrible credit crunch and debt burden confronting the American farmer. I will not take up the Committee's time with a recitation of the figures.

I come here today to urge the Committee to address not only the short-term crisis in farm credit but also the longer-term question of how to restructure the Farm Credit System.

Whatever we in Congress do to address the short-term problem, structural reforms will be necessary to assure the long-term availibility of the Farm Credit System. I believe those reforms must address the basic confidence problems plaguing the system: The lack of confidence in the capital markets and the lack of confidence by borrowers.

We must design a system that provides both discipline and local control. the Farm Credit System was created as a cooperative farm-owned and locally-controlled system. We should be careful not lose the strengths provided by this cooperative structure.

The bill I have introduced, S. 1790, offers a comprehensive approach to this long-term problem. It replaces the Farm Credit Administration with a true insurance and regulatory agency along the lines of the FDIC and similar Federal agencies. Into this central regulatory agency -- the Federal Farm Credit Insurance Corporation -- would flow approximately half the reserve assets from present system institutions. The bill requires the use of generally accepted accounting principles by the System's banks and PCAs, annual audits, and annual publication of financial statements. Equally important, I believe, the bill retains and strengthens the cooperative nature of the system.

The importance of this cannot be overemphasized. Total abandonment of local control would overturn the grassroots nature of this credit system. I believe -- as do most members of this Committee -- that would be a terrible loss.

The Administration has finally announced a position on assisting the Farm Credit System. I applaud their recognition of the need for a true arm's length financial regulator. But when I look at the Administration's proposal one question jumps out:

Where's the farmer? Where's the borrower-shareholder?

The administration seems to have forgotten the history of this system: a history of local control and of cooperative effort. We should not give that up. I don't think creating an all-powerful central bank holding company is the answer to the farm credit system's problem.

Mr. Chairman, I will not take up more of the Committee's time. You have witnesses scheduled today who can talk to you about actual experiences with the system. I urge this Committee to tackle both the short-term crisis and the longer-term structure of the Farm Credit System. I believe my bill, S. 1790, offers a framework for restructuring the system, and I urge the Committee to consider it.

We own our farmers a sound and well-run Farm Credit System.

STATEMENT OF HUBERT H. HUMPHREY III
ATTORNEY GENERAL OF THE STATE OF MINNESOTA

My name is Hubert H. Humphrey, III. I am the Attorney General of the State of Minnesota. I am pleased to speak to you today about issues which are of great importance to the farmers of Minnesota and the Nation.

I am here today first as an independently-elected state official from Minnesota. Because Minnesota is a largely agricultural state, my constituency is directly affected by the serious difficulties in today's agricultural economy. Second, I am here as one of several midwestern attorneys general concerned with Farm Credit System practices. Finally, I am the chairman of the Agriculture and Rural Legal Affairs Committee on the National Association of Attorneys General.

Fairness and Right of Review

The issue which I will address is that of fundamental fairness for the Farm Credit System borrower. There are two principal facets to this issue. The first is the need for the Farm Credit System to give its borrowers sample notice of adverse credit decisions and a right of review of those decisions. The second is the need for the System to adhere to the letter and spirit of its own regulations.

Fundamental fairness requires that a borrower be given sufficient notice of a potential change in this status to remedy the problem. It also requires that the borrower be provided with meaningful review--by someone other than the original decision-market--of any adverse credit decision.

Neither of these elements is presently a regular part of Farm Credit System practices. for example, a farmer from Dakota County, Minnesota, had a solid payment record with his Production Credit Association for 15 years. Last year he become one month delinquent, and received an acceleration notice from the PCA. The notice stated that he had 15 days to pay on his note. However, he received the notice only 3 days before the 15 day period expired. Surely this is a prime example of woefully inadequate notice. Fortunately, the farmer was able to negotiate a settlement with the PCA which extended the time allowed for repayment, and he promptly brought his payments up to date. Unfortunately, simultaneously with the acceleration notice, the PCA also told the farmers that his interest rate would be increase by 2.8 per cent because he was now consider a "problem" borrower.

The farmer brought his loan up to date and paid the increased amounts through September of this year. He then requested that the PCA review his situation and lower his interest rate to its prior level. The bank refused, telling the farmer that his classification as a problem borrower was indefinite and not reviewable.

Similarly, a farmer from Kandiyohi County, Minnesota, was recently informed that his Production Credit Association had devalued his collateral and classified his loan as uncollectible. This farmer has been with the PCA for 29 years and always has been up-to-date on his payments. His crop was devalued not because he was delinquent but because he did not have all peril insurance. However, the farmer had never been informed that all peril insurance was necessary. He had always been told that hail insurance, which he has, was sufficient. Now because it is too late for him to get all peril insurance, he is not able to obtain additional credit from the PCA for harvest. Again, the farmer was told that the lender's decision was not reviewable.

These stories illustrate the need for the fundamental elements of notice and hearing in the Farm Credit System. These elements are basic to our notions of fairy play. In addition, the effect in these situations, as in many others, is to potentially squeeze out the farmer who is still making it today, but who may be forced out unnecessarily if he is not given some objectively reasonable opportunities to continue on. This result is inconsistent with the purpose of the Farm Credit Act and is not in the public interest.

In addition, the Farm Credit System must take care to abide by its own regulations. An issue of particular concern in this regard is the apparent failure of System lenders to adhere to current regulations and establish appropriate standards regarding the appraisal of land value. While the regulations establish principles of appraisal, the lenders have instead adopted a policy of using "benchmark farms" to value real estate for an entire state. For example, Minnesota has over 94,000 farms and 87 counties. However, Farm Credit Services in St. Paul uses only 33 benchmark farms in 28 counties to appraise Land Bank security in the state. It must be seriously questioned whether these benchmark farms are sufficient to assess land values in Minnesota where over half of the farm real estate debt is held by the Farm Credit System. This issue is particularly important today when numerous System borrowers are being declared in default, not because they are delinquent in their loan payments, but because their collateral is being rapidly and drastically devalued.

Conclusion

I hope that these comments will be of use to your in your deliberations. I urge that any financial assistance package which is provided to the Farm Credit System be coupled with statutory requirements that will assure consistent fairness in the System's dealings with its borrowers and shareholders. Such a mandate will fulfill Congress' objectives in enacting the Farm Credit Act. It will also help return agriculture to a healthy, productive condition.

The Honorable Donald E. Wilkinson
Governor, Farm Credit Administration
1501 Farm Credit Drive
McLean, Virginia 22102-5090

Dear Governor Wilkinson:

This letter is written to share with you our concerns regarding current practices within the Farm Credit System. As you know, the past four years have witnessed a dramatic deterioration in the agricultural economy within our states. Thousands of farmers face insufficient cash flow, declining asset values, problems of access to credit, forced liquidation, foreclosures and bankruptcy. The latter fact is underscored by the record number of farm bankruptcy filings which have occurred this spring through the Midwest. See "Record total of farms use bankruptcy courts," Des Moines Sunday Register, March 17, 1985. The data suggest as well that the pressures pushing many farmers towards insolvency will continue in the near future. See, The Current Financial Condition of Farmers and Farm Lenders, Economic Research Service, U.S. Department of Agriculture - Agriculture Information Bulletin No. 490, p. 17.

Against this background, as the chief legal officers of our respective states, we have been contacted with increasing frequency concerning the range of economic and legal problems currently facing our farming communities. We believe that the experience of our states and the critical condition of the agricultural economy reflect problems similar in all agriculture states.

The present financial stress within agricultural communities has been transmitted to farm lenders through loan delinquencies, inadequate security and, in some instances, insolvency and the failure of lending institutions. The Farm Credit System itself currently holds over 30 percent of all farm debt. Id. at X. Consequently, it has experienced increasing stress in recent years. Id. at 25. This stress on the Farm Credit System in turn has led, over the past five months, to an increasing number of complaints to our offices about its lending policies and practices. Our staffs have fielded inquires from farmers across our states raising significant issues about Local Production Credit Associations, Federal Land banks, regional Federal Intermediate Credit Banks as well as general policies and procedures at the Farm Credit Board level. The spectrum of complaints is broad, and appears to reflect a serious impact not only on the Farm Credit System borrowers but farming generally. For the individual farmer it has often meant frustration and the threat of economic loss; in many instances it has meant the loss of the farm and a way of life.

In the Farm Credit Act of 1971, Congress expressly adopted the following declaration of policy:

> It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free national and recognizing and growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations. 12 U.S.C. section 2001(a).

The increasing frequency of complaints from farm constituents has convinced us that abuses within the Farm Credit System are threatening this Congressional objective. If the Congressional purpose of improving the well-being of American farmers through the Farm Credit System is to be accomplished, reform is essential. By means of this open communication to you, we hope to bring to the forefront a range of problems within the Farm Credit System which threaten the well-being of farmers throughout our respective states.

This letter serves three basic purposes. The first is to share with you our profound concern over the dimensions of the farm credit problem. Second, we seek to identify specific problems in the Farm Credit System that we have recognized in working with farmers across the Midwest and to suggest reforms which may relieve these problems. Finally, we state that we are considering a petition for rulemaking before the Farm Credit Administration. In the interim, we seek to lay out the general range of issues that we have identified as being in need of review and revision by the Farm Credit System.

The discussion which follows is organized into six sections:

- I. Disclosure of Terms
- II. Access to Documents and Information
- III. Appeal to Fairness and Review
- IV. The Doctrine of Forbearance
- V. Shareholder Rights
- VI. Conclusion

These issues have been identified through repeated complaints by farmers within our states and highlighted the end for rulemaking and reconsideration of policy within the Farm Credit System.

I. Disclosure of Terms

We initially observe that, as a general rule, full disclosure of terms of any contract is of positive benefit to all parties. Many farmers have indicated that they were not given details regarding the terms of their loans. For example, farmers oftem are unaware of the effective interest rate on their loan or the variable interest rate mechanism. Furthermore, member borrowers are not made aware of what standards, if any, apply to the multiple rate loan levels at their Production Credit Associations. Finally, because of this lack of full disclosure, borrowers and frequently unclear about the potential effect of their loans on the cash flow of their operations.

We believe that the Farm Credit Administration should adopt rules which provide this very basic information.

First, we recommend that the Farm Credit Administration require that its member institutions incorporate provisions of the Truth-In Lending Act and Regulation Z as an essential element of their lending practices. Included into his approach would be a clear statement of the terms of the loan, including the annual percentage rate. We note that although some loam manuals and contracts allude to the Truth In Lending Act, it appears that few Farm Credit System lenders adhere to its principles. It is also our belief that the effective rate of interest should reflect the additional costs of the ten percent stock purchase for Production Credit Associations loans and the five percent stock purchase for Federal Land Bank loans. This purchase is, in fact, an essential cost of the loan and adds between one and two percent to the actual rate of interest charged.

Second, when an interest rate is on a variable schedule, the lender should set out with clarity the potential future impact of the method of calculating the interest rate. To further clarify the application and function of variable interest rates, the lender should reveal the formula by which the rate is determined and disclose the factors upon which the rate is based. Most Farm Credit System lender do not currently have any precisely defined formula nor any cap on the levels to which variable interest rates may rise. In the home mortgage industry, however, it is fundamental to have an accepted formula and an overall cap on both the variable interest rate and the total increase which can occur in a single year.

We believe that both farmers and Farm Credit System lenders would benefit from such disclosures, the farmer because it would allow for meaningful planning for expenses and the lender because fewer borrowers would find themselves in jeopardy because of unexpectedly high rate and consequent cash flow difficulties. In the same vein, it would be of benefit to all borrowers to be exposed to the potential effective rate changes on cash flow. Tables showing a simple computation of the rate, payment schedule and the effect of rate changes on the cash flow on the farm would be a positive aid to both farmer and lender as loan size and terms are discussed. Finally, the lender should give notice of an increase in the rate thirty days before it is to be implemented in order to allow borrowers the opportunity to consider alternatives.

Over the past few years, a new issue has arisen within the Farm Credit System with the advent of multiple rate levels for loans to different farmers within a given lending area. The Farm Credit Administration should evaluate whether this practice causes a steady failing of borderline borrowers by hastening their financial failure in farming. Even assuming that it is determined that the levels serve a beneficial purpose, the lender should establish and clearly disclose the standards and requirements for each rate level. Further, great care should be exercised to assure equal and fair treatment of each borrower similarly situated.

The other primary area of importance to the borrower at the time loan terms are discuss is the policy and procedure in the event of default. For example, the lender should inform the borrower about events which may trigger default, including a description of the right of the lender to deem itself insecure and accelerate the loan. The lender should specify the borrower's options when faced with default, including the right to review the situation with the lender, as well as the means of curing the default. The procedures for default and liquidation of stock should be made clear including the lender's policy relating to foreclosure.

To ensure that disclosures are properly made and are fully understood by the borrower we recommend that each lender in the Farm Credit System obtain a signed declaration of disclosure statement which fully describes the terms of the specific agreement as well as pertinent policies and procedures of the lender. Further, we suggest that the borrower be given the opportunity to review and consider the terms of the loan for three days after the disclosure statement has been signed. Finally, we urge that each disclosure statement advise in boldface type that the borrower has the right to consult a lawyer at any time during the negotiation or the term of the loan. Following these procedures will ensure that both the borrower and lender will be fully aware of their rights and responsibilities during the loan period at the outset -- thereby helping to avoid conflict and confrontation later.

Each district board is required by 12 C.F.R. section 611.1010(g) to adopt consistent lending and operating policies for each bank and all associations in the district. We would suggest that the Farm Credit Administration consider recommending that each of its members develop and establish policies which require a full and fair disclosure of the terms of loans to its customers. Not only should these procedures be enforced, but the resulting documents should be available for borrowers to examine in order to understand policies and procedures in effect.

II. Access to Documents and Information

One of the most common complaints about the Farm Credit System received by our offices concerns the failure of its lenders to provide copies of documents which should be available to the farmer. Access to documents and information in fundamental to good business practice, whether it be as a lender towards its borrowers, or as a corporation toward its shareholders. In either case, complete and open access serves both the Farm Credit System and it borrowers.

We recommend that the Farm Credit Administration require its member institutions to furnish all documents basic to the loan transaction to any farmer who borrowers capital within the Farm Credit System. Currently, many borrowers report that they don't receive copies of their documents at the time of their loan; others find it extremely difficult or impossible to obtain copies of their loan documents. We see no logic or benefit to this policy. As a matter of course the borrower should be given copies of all documents which are basic to the loan transaction including but not limited to the contract, mortgage, financing statements, assignments, cash flow statements, the disclosure statement (if adopted), and other related documents. Certainly, any document which is signed by the borrower should be automatically available. Documents and information regarding policies and procedures of the lender should always be readily available to the borrower.

A similar problem confronts farmers in their role as Farm Credit System shareholders. While it has always been a policy of corporate and cooperative law in this nation to have open and reasonable access for shareholders to germane corporate documents this does not seem to be the practice within the Farm Credit System. Information received by our offices indicates that many Production Credit Associations have been reluctant to provide shareholders with copies of articles of incorporation, by-laws, local rules and policies or information on voting rights, all typically available to cooperative or corprorate shareholders. We similarly encourage the Federal Intermediate Credit Bank to offer reasonable access to pertinent documents and policies. The Farm Credit Administration has already recognized that access to this type of information should be a general right of stockholders. See, 12 C.F.R. section 611.1125.

Finally, we would recommend that the Farm Credit Administration and its member institutions make available on a general basis copies of the loan manual presently used by the lender. We can thank of no valid logic for not having this available to shareholder/borrowers. It informs them on business procedures of their corporation while at the same time it acquaints them with what they can expect as borrowers. Finally, it allows borrowers to be aware of an enforcce their rights. If lenders are proceeding properly, they have nothing to fear from disclosure. It is a healthy policy for all concerned.

In this context, we feel it is important to emphasize the need for information concerning the financial status of member institutions. Increasing financial concerns within the Farm Credit System demonstrate that there are serious questions about the true financial status of individual member institutions as well as the Farm Credit System as a whole. The initial problem is clearly the difficulty in obtaining accurate and meaningful reports on either regional or local entities within the Farm Credit System. We join others supporting a complete audit of local and regional entities within the system by the General Accounting Office.

Coupled with this request is a recommendation that the Farm Credit Administration evaluate current accounting principles and established standards and procedures to ensure that they will accurately reflect the true status of the Farm Credit System and its individual entities. At a time when the Farm Credit System claims severe loan losses and shares losses among districts and members, it is most important that loan losses be determined in conformance with generally accepted accounting principles. We would further ask that there be a statement concerning any change in the accounting methods in the past five years along with the report on the effects of that change.

III. Fairness in the System and Right of Review

One of the primary issues which has come to our attention is that of fundamental fairness for the farmer/borrower in the Farm Credit System. There are three principal facets to this issue. The first is notice and the second is the need for a review procedure of lender decisions affecting individual borrowers. The third issue is the need for the system to adhere to the letter and spirit of its own policies, rules and regulations.

As a matter of Farm Credit System policy, borrowers should be given notice of impending activities or changes in their status within the system. Too often the borrower becomes aware of the change at a time when it is too late for both borrower and lender to take action potentially advantageous to both. Simply fairness dictates, for example, that a borrower who will not be renewed for an operating loan should be given timely notice, especially as it relates to current decisions. In one Iowa case a borrower was encouraged by this local Production Credit Association to buy three hundred heifers in November. Shortly after the heifers were delivered, the lender advised him that his operating loan were not to be renewed for the coming year. He was left with three hundred cattle and no source of funds to feed them out during the winter months. No valid purpose was served by the failure of the Production Credit Association to inform its borrower of the probable nonrenewal of the operating loan. In fact, neither borrower nor lender benefit from this approach.

The law now provides applicants with the opportunity for an informal review of credit decisions. See, 12 U.S.C. section 2202 and 12 C.F.R. section 614.4441. However, in situation after situation reported to our offices, it is apparent that there is no meaningful internal review of decisions which can dramatically change the lives of farmers and their families. Fairness dictates that decisions vis-a-vis farmers should be afforded a full de novo review by a group of impartial board members or a committee established for the purpose of review and not merely a cursory reevaluation by the original loan officer and his or her immediate supervisor. The procedure currently in effect is unrealistic and unfair.

The Farm Credit System is founded on the principle of providing for farm credit through a farmer-controlled lender. It therefore makes sense to ensure that borrowers are given fair treatment and impartial review within the system if they believe that a loan officer has made a wrong decision or placed the borrower in an untenable situation. For example, review should be available not only when when credit is denied or reduced by when there is: (1) notice of the need for new or increased collateral, (2) notice of acceleration of a note when a loan is deemed insecure, and (3) an issue of forebearance. Fairness can only be attained by creating a more clearly defined procedure which will make certain that there is a review by persons not concerned with the original transaction.

Finally, employees of the Farm Credit System must take care to adhere to the applicable regulations. One clear example is revealed in the rash of complaints we received concerning loan officers' practice in past years of encouraging farmers to borrow more money than needed or requested. No doubt the farmers were pleased with the confidence of the loan officers in their ability to manage operations of increasing size. Loan officers did not disclose that they were paid in part on a commission basis, and therefore their pay depended upon the amount of money they could put into farmers' hands. In some cases prizes and trips were awarded to officers who loaned out the most money. It would appear to us that such a program creates a direct conflict of interest between lender and borrower. Not only is it bad policy but it funds counter to 12 C.F.R. section 601.110(d), wherein officers and employees of the Farm Credit System are prohibited from accepting any commission "which might reasonably be interpreted by other as being of such a nature that it could affect his impertiality." Farm Credit regulations are designed to serve both borrower and lender and should be scrupulously followed.

Another example of the failure to lenders in the Farm Credit System to adhere to current regulations and establish standards is in the appraisal of land value. While the regulations establish the general principle of appraisal at 12 C.F.R. subsections 614.4220(a) and (b), the lenders have instead adopted a policy using a few "benchmark farms" to value real estate for an entire state. For example, the Federal Land Bank in North Dakota, a state with 36,000 farms, uses only sixteen "benchmark farms" to establish land values for all farmers even though thirty-six counties do not have a "benchmark farm" within their borders.

IV. Doctrine of Forebearance

We urge the development of a well-defined standard and procedure for implementing the policy of forbearance set forth in the regulations. In this regard, we particularly encourage forbearance when the borrower is unable to make payments as a result of circumstances which are beyond his or her control. The forbearance standard should also include a commitment by Farm Credit System lenders to work with other lenders and with suppliers to resolve the fiscal problems of financially troubled farmers. Finally, the standard should incorporate special consideration for the preservation and maintenance of family living and farm operating expenses as well as the value of collateral. These needs of the borrower should be given priority to the use and distribution of income in order to maximize the borrower's ability to "[work] out of the debt burden." 12 C.F.R. section 614.4510(a)(1).

Whatever the standard for forebearance is, and even if it remains the simple statement currently included in the regulations, we urge the Farm Credit System lenders to provide borrowers with personal notice of the availability of forbearance. In order to enhance the borrower's awareness in this regard, we suggest that borrowers be notified of the availability of forebearance at four points during the loan process: (1) at the outset of the loan term; (2) at the beginning of each production season; (3) when a borrower is notified that he or she is delinquent; and (4) when a borrower is given an accelerated notice. See Curry v. Block, 738 F.2d 15567, 1562, (11th Cir. 1984) (Farmers Home Administration's duty to implement deferral relief program under 7 U.S.C. section 1981a).

V. Rights of Shareholders

Although the principal relationship of the farmer to the Farm Credit System is that of borrower, he is also a shareholder by virtue of the requirement that he purchase a certain amount of stock in the lender when obtaining a loan. As shareholders, farmers are entitled to the disclosure of certain information and records relating to their rights as shareholders. We would go on the observe that additional rights ought to be established and protected.

First, we recommend that all loan agreements require that shares held by a farmer be retired on a pro rata basis as the note is paid off. The recent practice established in the Iowa Production Credit Association stock freeze of retiring the stock at the end of the loan period is a serious disadvantage to the borrower. As it currently stands farmers in the areas of frozen Production Credit Association stock have up to $40 million unavailable at a time when credit is extremely difficult to obtain.

Second, stockholders should be notified of any rights or claims the lender may have against stock held by farmers and any impending action which might adversely affect the value of that stock. As an example, notice and right of review should be accorded the individual farmer if stock is being use of offset a loan.

Third, although we discourage liquidation as a solution to Farm Credit System lender difficulties, should this step be necessary, the rights of stockholders should be protected to the maximum extent possible. Stockholders should be given notice of the proposed liquidation and reasonable opportunity to respond. Although the Farm Credit Administration has adopted limited regulations in this regard, see 12 C.F.R. section 611.1163 (proposal at 50 Fed. Reg. 6002), the proposed notice provision is inadequate. See comments of Attorney General Nicholas J. Spaeth dated May 7, 1985; and Attorney General Hubert H. Humphrey, III dated March 13, 1985, joined by Attorney General Thomas J. Miller dated May 10, 1985. In addition, we urge the Farm Credit Administration to direct its member lenders to ease the transition when a liquidation does occur. Whenever possible, the Farm Credit System should liberalize the financing for required new stock purchases in such circumstances, including, but not limited to, extending the time period in which such purhcases may be made.

Fourth, we are further concerned by the lack of standards or factors within the Farm Credit System for the payment on dividends to its members. We understand that in the past it has not been the practice of ember institutions to pay out dividends, even in profitable years. We urge that this practice be reevaluated, and that the Farm Credit System set reasonable standards for payment of dividends. We believe that this policy should be set forth in the by-laws of the lending institution. Further, we would suggest that a study be made concerning the treatment of profits over the years, and particularly in the past fifteen years.

Last, we believe that the original philosophy of the Farm Credit System as locally owned, farmer controlled lenders is being threatened by increase system centralization. Over the past decades the supervisory role of the Farm Credit Administration has increased until it now appears that the Farm Credit System policies are set at the national and regional levels while the original concept of local control has been largely extinguished. This trend is continuing and accelerating as illustrated by the recent creation of the Farm Credit Corporation of Denver as the central policy making institution for the entire system. One recent example of loss of local control was found in the Federal Land Bank Association in Lamoure, North Dakota. Having suffered losses due to long-term drought, the Association's Board contemplated merger. The St. Paul District office broadly intervened and attempted to take control entirely from the local board by a refusal to recognize the board or to make money available through the board as well as the filing of a lawsuit. The problem was resolved with the help of the North Dakota Attorney General.

Of equal significance is the recent decision by the Omaha District officer which has proposed to forbid board member from holding office if their loans are placed in a problem category. This, in effect, takes away the traditional right to vote for the person the shareholder chooses for the board of directors as well as prohibiting a shareholder from seeking a position on the board.

VI. Conclusion

The current difficulties in American agriculture are taking a dramatic toll on farmers as well as on the Farm Credit System, the major agricultural lender in the country. This is a time for reevaluation and reconsideration of policies and procedures which will serve both the Farm Credit System and its farmer borrowers. The recommendations in this letter and the petition for rulemaking which will follow seek to remedy patterns of problems which have emerged with frequency in the complaints by farmers. These suggestions and the ensuing rulemaking are submitted in the belief that meaningful benefits will result for lender and borrower alike.

The regulations of the Farm Credit System are designed to help member institutions succeed as lenders and to serve farm borrowers. Each of the regulations should be enforced by local and regional offices as well as by the Farm Credit Board. The spirit of service and responsibility to farm borrowers should be the primary guide to the application of current regulations and the adoption of appropriate new regulations.

In Allison v. Block, 723 F.2d 631, 638 (8th Cir. 1983), the Eight Circuit Court of Appeals, in describing a program within the Farm Home Administration, wrote:

> We realize that the plight of many farmers throughout the nation is so bleak that the forebearance of creditors will not save their operations. We are also aware, however, that the agricultural industry is especially vulnerable to the changing winds of time, nature, fate, and the economy; farmers of skill, perserverance, and dedication are no less vulnerable. Congress in 1978 clearly expressed its intent to assist farmers blown astray by these winds by granting those who could show that their inability to meet their financial obligations were temporary more time to repay their debts to the government. It commissioned the Secretary to implement this intent not as a private banker, but as a public broker...

American farmers are no less vulnerable to the abuses within the Farm Credit System than the changing winds to time and nature. We write this letter to urge that reforms be undertaken to enable the Farm Credit System to again function in the public interest. In that way agriculture, so basic to our well-being as a nation, can be returned to a healthy and productive condition.

Sincerely,

Neil F. Hartigan, Illinois Attorney General; Linley E. Pearson, Indiana Attorney General; Thomas J. Miller, Iowa Attorney General; Robert T. Stephan, Kansas Attorney General; David L. Armstrong, Kentucky Attorney General; Hubert H. Humphrey III, Minnesota Attorney General; William L. Webster, Missouri Attorney General; Robert M. Spire, Nebraska Attorney General; Nicholas Spaeth, North Dakota Attorney General; Mark V. Meierhenry, South Dakota Attorney General; Bronson C. La Follette, Wisconsin Attorney General.

STATEMENT OF HON. NICHOLAS J. SPEATH
ATTORNEY GENERAL OF THE STATE OF NORTH DAKOTA

DELIVERED BY SARAH M. VOGEL
ASSISTANT ATTORNEY GENERAL

Thank you for the opportunity to testify. My name is Sarah Vogel. I am an Assistant Attorney General for the State of North Dakota. I am appearing on behalf of Nicholas Spaeth, Attorney General.

In the interest of brevity, I will not repeat the content of the letter which Mr. Speath and the other ten Attorneys General sent to Governor Wilkinson on September 24, 1985, but rather provide several North Dakota illustrations of the abuses mentioned in that and letter and explain why the requested reforms are necessary.

As stated in the letter to Governor Wilkinson, certain simple, inexpensive reforms would do much to increase the fairness of the FCS system to its borrower/stockholders. In North Dakota, the actions and behavior of the Farm Credit Services are crucial to our State's well-being. We are probably the nation's most agricultural state and the Farm Credit System is our largest lender. In 1984, we had only 34,000 farmers; but there were 15,9121 FLB loans and 9,033 PCA loans for a total volume of FCS credit outstanding of $2,037,109,000.

According to the Farm Credit Service, many of the FCS borrowers in this district have very severe cash-flow problems. Net farm earnings for the average St. Paul borrower were $32,987 in 1979, and $24,180 in 1980. However, the average net farm earnings for the years 1981 through 1984 were only $2,350--before payment of any family living expenses. After subtracting family living expenses and after adding off-farm employment income, the typical Farm Credit System borrower in the St. Paul district had net farm earnings of -$13,140 in 1981; -$12,602 in 1982; -$7206 in 1983, and $-10,390 in 1984. With financial problems of this magnitude, it is crucial that FCS borrowers receive fair treatment.

Disclosure of Terms

With respect to disclosure of terms, farmers in North Dakota, as elsewhere, are mystified by the variable interest rate procedure used by the Federal Lank Bank of St. Paul and its Intermediate Credit Bank of St. Paul (hereinafter "St. Paul"). As an attorney in private practice, I was familiar with the use of fixed rates (as used, for example, by the Farmers Home Administration) or variable interest rates with caps on interest rate hikes and based on specific formula (as used in housing loans). When I first encountered a FLB borrower, and studied the documents and methodology used by FCS lenders, I was shocked and I remain shocked.

Each FLBA borrower is told what the "basic rate" (the rate at the time of loan closing) is, but below in fine print appears the following:

> The Bank shall have the right to establish different rates of interest, either higher or lower than stated above, which shall thereupon apply to the debt evidenced hereby until different rates of interest are again established. Such different rates shall be established in accordance with Farm Credit Act of 1971 and the regulations of the Farm Credit Administration as then existing; shall include a rate applicable to the unmatured portion of such principal sum and a higher default rate applicable to all sums of sums of principal or interest not paid when due. The interest rates specifically stated above, and any different rates hereafter established, shall not be limited by the laws of any state relating to a real rate or other rate of interest, but shall be governed solely by applicable federal laws.

The PCA borrow is not even told what the "basic rate" is in the Long Form Loan Agreement. It only discloses the following:

> Interest shall be charged at a variable rate specified by PCA from time to time in accordance with the Farm Credit Act of 1971, any Acts amendatory thereof, and all Regulations enacted thereunder. Such interest shall be charged on all principal from the date first disbursed or charged to Borrower, at the rate then in effective PROVIDED that each and every time the interest rate charged is raised or lowered, the rate on all outstanding principal shall be subject to such new rate from the date that it becomes effective.

Worse yet, PCA's loan documents signed at the inception of the loan do not even disclose what the repayment terms and dates will be. This works a particular hardship on farmers who borrower to purchase intermediate term assets where repayment cannot be expect from one year's production. The PCAs in fine print, state:

> Repayment.
>
> All borrowed principal shall be fully repaid with interest. The nature of borrower's business is such, however, that the parties may not always be able to

> fully determine in advance the exact number and dates and amounts of appropriate specific repayments. While PCA is willing to allow Borrower some flexibility, it is unwilling and unable to lend money without retaining ultimate control of the repayment requirements. Borrower recognizes that and is willing to allow PCA to vary the specific repayment requirements from time to rather than agree to a fixed schedule which Borrower would find unacceptably difficult or impossible to honor. Accordingly, repayments shall be in such amounts and at such intervals as are satisfactory to PCA from time to time. In that connection, OCA may request Borrower to agree to more specific repayment arrangements and amendments from time to time. If Borrower fails to agree to any such specific repayment arrangement or amendment proposed by PCA, all indebtedness shall be due and payable as and when demanded by PCA in writing....

That's a lot of words to say that a PCA loan must be paid exactly the way the PCA loan officer wants it paid.

But the absence of disclosure is not the worst of it--the worst is the variable rate changed by St. Paul is not based on any formula pursuant to which a farmer may refer; the rate charged is what St. Paul wants to charge.

This summer, despite the generally dropping cost of money which was reflected in lowered interest rates by other lenders, the St. Paul district raised is variable interest rate to 12 3/4% -- an increase of .75%. This interest rate increase, based on an assumption of steady 1984 Federal Land Bank Association loan volume in North Dakota, increased the annual interest expense by almost 11 million dollars in North Dakota alone. We stress that the Farm Credit System's financial distress cannot be solved by further increases in the variable interest rates charged to farmers. Indeed given the unbelievably high real interest rates being charged today, we submit the interest rate should be reduced to avoid further delinquencies, defaults, and foreclosures in North Dakota and elsewhere.

While we realize that Congress has authorized use of variable rates has specifically preempted state law regarding maximum interest rates, we cannot believe that Congress intended to approve the manner in which St. Paul and other system lenders have exercised that authority. Moreover, the absence of any sense of cost discipline which is allowed by total freedom to raise captive borrower's rates has probably fostered FCS excesses such as huge, monumental buildings, fleets of expensive late model cars and the October 1985 raises to most of the FCS district banks CEO's--which averaged 9%.

Access to Documents and Information

Recently, Farm Credit System lenders have made various assertions that they are willing to disclose significant documents to their borrowers. However, a recent experience we had in North Dakota, tends to show otherwise. The 1985 North Dakota Legislature established a Credit Review Board which was designed to help save the home quarters of farmers who were threatened with imminent foreclosure. The Board acts by providing free negotiators and an interest subsidy during the first three years of a loan. Because many of the distressed farmers seeking Credit Review Board assistance are FLB or PCA borrowers, the Credit Review Board asked for a copy of each institution's forbearance policy (which was required by FCA regulations 12 C.F.R. 614.4510 a(1)) and its debt compromise policy (also required by FCA regulation 12 C.F.R. 4510) (a copy of this letter of inquiry is attached as Exhibit 1).

To my knowledge, no PCA designed to replay. While several of the Federal Lank Bank Associations did provide copies of the guidelines, other did not respond at all. The Fargo FLBA simply state "...it is the position of the Association not to distribute its internal operating policies and procedures..." See Exhibit 2. We ask the Senate whether a farmer trying to determine if he might qualify under a forbearance policy would have any better success than an agency of state government in obtaining these documents.

Stockholder Rights

I would like to refer the Senators to the third exhibit to this testimony. It is a full page advertisement which appeared (at unknown expense) during October in virtually every major newspaper in the St. Paul district. What we found interesting about this advertisement is its repeated assertions to the Farm Credit System's commitment to farmer direction and ownership. For example, FCS state "[w]e stand by our commitment to farmer ownership and direction. We do so without reservation or exception and believe the Farm Credit System of tomorrow must remain true to this commitment." They also say "[b]ut among financial institutions, Farm Credit has always been one of a kind. We're farmer-owned and directed," and "[t]he individual farmer is the most important part of Farm Credit."

These "P.R." statements are excellent. We believe this is the way Farm Credit ought to be run. However, we would like to refer the Senate to a situation where this FCS commitment was not in evidence in North Dakota. By late 1984, the LaMoure Federal Land Bank Association's borrowers had been hard hit by drought for three of the prior five years. In addition, this area had suffered the cost-price squeeze common to all sectors of the agricultural economy. The Association accordingly suffered losses. The St. Paul district decided that it should merge with the Federal Land Bank Association of Fargo. The LaMoure directors were amenable to this merger but objected to St. Paul's demand that each of the LaMoure directors resign upon the merger. The LaMoure Board believed that the FCA regulations stated that they were entitled to serve with the Fargo Board until the next general election of the merged association. The Directors believed that resigning en masse at the suggestion of the St. Paul district officials would be a dereliction of their obligations to the members who had elected them. St. Paul thereupon fired all of the LaMoure Board members. Prior to the annual meeting, management officials of the Farm Credit Services wrote to each stockholder saying that if they attempted to re-elect the fired Board the Board would simply be removed by St. Paul. On the evening of the annual meeting on March 28, 1985, someone hired uniformed guards who kept the members outside (in a blizzard) until the meeting time started and thereafter watched over the audience. (I was there and I was intimidated.) St. Paul had decided that a gentlemen from Wisconsin would run the meeting. A motion was made from the floor that the meeting would be run by a local member and suggested that no one had come to hear the "gospel according to St. Paul." There was resistance but thanks to Roberts Rules of Order, the motion passed by an overwhelming margin. The St. Paul officials were given a fully opportunity to say their piece which they did (complete with an overhead slide explaining why a FLBA was not a "cooperative"). Nominations were made from the floor to re-elect four of the five original board members (the fifth had reached mandatory retirement age). The election was held by secret ballot and all four of the board members who had been fired by St. Paul were re-elected by overwhelming margins. Additional resolutions were passed to request an investigation of the firing of the local board and to determine whether the stockholders' rights had been infringed by St. Paul as well as to create a legal fund of $25,000 to support those efforts. At the end of this highly-charged yet peaceful democratic meeting, and after most of the farmers had left, a letter which I have attached as Exhibit 4 was handed to each of the original four board members. We recommend that each of you read this letter. We submit that stripping a local association of all powers and imposing personal liability on farmer directors for mere exercise of their elected authority hardly coincides with the FCA's pious assertions of strong commitment to farmer direction that appears in the FSC's paid advertisement.

Thank you for the opportunity to appear before you. I would be pleased to answer any questions you may have.

[EXHIBIT 1]

CREDIT REVIEW BOARD, STATE CAPITOL
Bismarck, North Dakota, August 19, 1985

Gentlemen:

In an effort to make our negotiators more informed and efficient, we would very much appreciate a copy of:

1) Your association's guidelines on forbearance as required by 12 C.F.R. 4510(d): "The (loan servicing) policy shall provide a means of forbearance for cases where the borrower is cooperative, making an honest effort to meet the conditions of the loan contract, and is otherwise capable of working out of the debt burden."
2) The guidelines you have received from St. Paul and that you have established locally on loan servicing criteria as they may pertain to debt compromise. _See_ 12 C.F.R. 614.4512: "...[No] compromise settlement of borrower indebtedness shall be made unless if can be determined from an analysis of all the facts and legal aspects that a

compromise settlement results in the greatest net return to the lender." The regulation further provides in 12 C.F.R. 4510 that the bank boards shall set policies, including approval limitations, for the compromise of indebtedness. We would also appreciate a copy of the policies.

3) FCA's and FLBA's may give non-farm and farm "rural residence loans" which may be in "open country." 12 C.F.R. 3040. does your association provide such rural residence loans and if so, would you please advise us of the loan terms, rates, and conditions so we can inform our negotiators.

At the meeting on July 30, 1985, Mr. Burgee Omdahl stated the loan servicing policies set by St. Paul and in the field may be changed in some respects. We would therefore appreciate copies of any loan servicing policy changes that may be made as they affect forbearance and debt compromise.

We appreciate very much the help and cooperation we have received from officials of the Farm Credit System.

Sincerely,

Steven W. Tomac, Chairman.

[EXHIBIT 2]

Federal Land Bank Association of Fargo
Fargo, North Dakota, September 20, 1985.

Mr. Steven W. Tomac
Credit Review Board
State Capitol
Bismarck, North Dakota 58505

Dear Mr. Tomac:

The Federal Land Bank Association of Fargo has received your letter dated August 19, 1985. Unfortunately, it is not possible to accommodate all of the requests outlined in your letter in that it is the position of the association not to distribute its internal operating policies and procedures. The association's internal policies and procedures closely parallel and comply with applicable FCA Regulations and Congressional statues, which are public documents and can be found at most libraries. These regulations and statues are closely observed in our lending operations.

Although I am unable to distribute the internal operating policies and procedures you requested, I have enclosed a sample promissory note and mortgage routinely used in our lending operations. These documents provide the terms of the contractual relationship established between a borrower and the association.*

In regard to your inquiry about rural residence loans, the Federal Land Bank of Saint Paul does have a rural home loan program. I have enclosed a brochure that explains the program.

I have also enclosed two sample mortgages routinely used in making these types of loans.

I hope you find this information helpful. If you have any further questions, please feel free to contact me.

Sincerely,

Robert W. Orseth, Association Counsel

*Enclosures not available.

[EXHIBIT 3]

HOW IS FARM CREDIT SERVICES DEALING WITH THE TOUGH PROBLEMS THAT FARMERS ARE FACING TODAY?

American farmers have always had to face tough times. But today is different. At a time when the American farmers are struggling just to break even. The situation has reached a near-crisis stage. As a result, virtually every farmer and every ag-related business is facing painful and difficult decisions. The same is true of the Farm Credit System.

While some financial institutions appear to be turning their backs on the plight of the farmer, Farm Credit Services is not. Along with farmers, we are facing these issues head on.

That's because agriculture and the Farm Credit System are inseparable. We are fully committed to agriculture. It's our only reason for being. Because we are owned by family farmers and cooperatives, we are completely dedicated to serving the needs of the family farmer. In good times and tough times alike.

We are making many important changes. Under the direction of our boards of farmer directors, we are making many improvements. In addition, we are asking for vital federal assistance to supplement our own efforts.

But most importantly, we are asking for the continued support of our member-owners. Working together, the Farm Credit System will continue to serve agriculture-and therefore all of America-today and for many years to come.

Because we are member-owned, it's vital that every one of our more than 100,000 farmer stock-holders in the Seventh District know how we are facing these issues.

Why should there be government assistance?

There is deep economic depression in agriculture and little prospect for near-term turnaround. As a result, there is more agricultural debt than can possibly to repaid by farmers or absorbed by lenders under current conditions.

The nation (and therefore government) has a large and legitimate stake in the survival of agriculture. The future of rural American depends on it. Moreover, agriculture is the nation's largest employer, generating more than 15% of all employment. And for almost 20 years, agriculture has been the largest positive contributor to the U.S. balance of trade, generating 10-20% of the U.S. total.

As an agricultural lending cooperative whose portfolio and sole business is totally agriculture, Farm Credit cannot deal with losses by withdrawing from the business, as some commercial banks have.

Therefore, Farm Credit believes government assistance is both necessary and appropriate. Agriculture doesn't need a "bail out" but it does need and warrants assistance.

There is precedent for such assistance. The Farm Credit System was founded shortly after the turn of the century at a time when agriculture was in trouble and when a dependable, reliable source of credit was not generally available to farmers from commercial banks.

Reflecting the importance of agriculture and the availability of ag credit, Farm Credit was started with the assistance of public money...all of which has long since been repaid by the farmers of America.

That initial assistance helped build a farmer-directed system to raise and deliver competitively priced capital to rural America. For nearly 70 years, the Farm Credit System has provided a dependable, reliable source of credit to rural America.

For the sake of agriculture, and the nation, the Farm Credit System must continue to fulfill its essential and unique mission.

Both Congress and the Administration has indicated that they regard government assistance as last-resort help for the System, and that they expect Farm Credit and its members to exert all efforts to help themselves before turning to government.

We affirm that principle! Reflecting its independent, non-governmental status. Farm Credit believes and is actively pursuing ways in which government assistance can be used to accompany the self-help efforts of Farm Credit itself and the individual efforts of its farmer members...but in the firm belief that any such assistance should be done in a manner which ensures continued farmer-control of the Farm Credit System.

How soon do farmers need governmental assistance? Now. Those farmers suffering acute financial distress cannot wait much longer. And those farmers whose loans are current cannot endure increased interest rates. The longer government delays, the high the cost to the American public.

How will changes in Farm Credit affect member stock?

To help protect our members' stock here in Michigan, Minnesota, North Dakota and Wisconsin, the 7th District Farm Credit Services Board of Directors--a group composed entirely of farmer stockholders--has recently approved an important plan. The plan calls for the pooling of resources of the FICB/PCA System to enhance the financial strength of PCAs, and the plan places the financial strength of the FLB/FLBA System in a like manner to assist FLBAs. This plan would greatly reduce the risk that any association might be liquidated, and thus also reduces the risk that any members' stock might be impaired.

Will Farm Credit Services continue to be a dependable source of credit to agriculture?

Yes. Farm Credit has over $76 billion in assets and is the largest agricultural financial credit institution in the world.

It supplies over a third of all credit needed by the nation's farmers.

On behalf of over one million farmer-members nationwide, Farm Credit raises this enormous amount of capital entirely in the public money markets and does not have the advantage of any governmental subsidy.

Farm Credit has...and continues to maintain investor respect. "Don't believe those scare headlines. The Farm Credit system isn't going to fail. And that means investor opportunity." Fobes, September 9, 1985. This is due to the fact that Farm Credit has never failed to make interest or principal payments on time since its inception almost 70 years ago.

Will Farm Credit remain competitive?

Even though our interest rates may, in some cases, seem high today, if you track our rates over time and compare Farm Credit rates to those of commercial banks and other sources of credit, Farm Credit interest rates have consistently been lower.

To ensure that we continue to be competitive, a concentrated effort is under way to reduce operating costs and make our organization more efficient. Plus, creative measures have been taken to offer a variety of credit terms that make Farm Credit more attractive to farmers and cooperatives.

How important is farmer control?

The individual farmer is the most important part of Farm Credit. When we were founded nearly 70 years ago, farmers dealt with banks on an individual basis. They had little clout. The Terms and conditions of credit were shaped by the needs of the banks. Not by the needs of the farmers.

That's why farmers gathered together to create Farm Credit-a farmer-directed, member-owned organization established to raise capital for rural America.

We stand by our commitment to farmer ownership and direction. We do so without reservation or exception and believe the Farm Credit System of tomorrow must remain true to this commitment.

How will Farm Credit provide better service?

Responding to the direction of our farmer-elected boards, certain aspects of Farm Credit Services are being changed. We are streamlining our district operations by consolidating our 96 PCAs and FLBAs with overlapping territories into 23 Farm Credit Service centers. Our farmer-directors believe this is Service centers. Our farmer-directors believe this is the most efficient and effective way for us to serve our member-owners.

Why? Because by lowering operating costs, we will be able to maintain more competitive rates and fees for our borrower members. And, it means members will receive fast, local service. total credit and financial needs of farmers are met by one organization at one location right in the farm community.

Will all of these changes make Farm Credit more like a big bank? Absolutely not. Farm Credit has always been big. And it's always been one system. This gives us strength to compete successfully in the money markets. But among financial institutions, Farm Credit has always been one of a kind. We're farmer-owned and directed.

What is Farm Credit's plan of action?

As farmers, you've had to take tough measures to cope with the challenges of the times. You've had to do more with less. So has Farm Credit. That's why we have an important plan that deals with every issue facing Farm Credit directly. Everything from competitive interest rates, reduced operating costs, federal legislative action, to improved communication.

We're making sure that Farm Credit will continue to serve farmers and cooperatives in the future.

As the farm industry continues to change and as our members' needs change, we will Farm Credit, so will Farm Credit. While these are tough times, we believe there's a tomorrow for agriculture. Because it's our country's most important asset.

And we believe in the future of Farm Credit. Farming is an incredibly capital-intensive business. By joining together within Farm Credit, farmers can successfully compete for that capital. That's why Farm Credit is so important, especially right now.

It means we're going to have to work together like never before. But then, that's why Farm Credit was created in the first place.

If you'd like to know more, or would like to share your thoughts, write, call or better yet, visit with your local Farm Credit Services loan officer.

[EXHIBIT 4]

Farm Credit Services,
St. Paul, Minnesota, March 28, 1985.

Federal Land Bank Association of LaMoure
202 S. E. First Street
LaMoure, North Dakota 58458

Dear Sirs:

This is to advise you that effective immediately the FLBA of LaMoure is expressly prohibited from taking any action without the express prior written consent of the Farm Credit Services, St. Paul. All prior delegations of authority including, but not limited to, issuance of checks, drafts, or payment of any bills, the incurring of any expenses, the hiring or termination of any employees, or any actions with respect to making or servicing loans are expressly revoked. The Association may continue to accept payments on loans, provided those payments are immediately transferred to FCS in St. Paul. Please be advised that any actions taken without such express prior written consent will be considered by FCS to be personal actions of the individual taking such action and outside the course and scope of the individual's authority.

You are further advised that FCS and/or FLBA of LaMoure will pursue recovery, from the individuals involved, of all costs incurred by FCS and/or the FLBA of LaMoure in connection with further actions necessary to remove the former board members previously terminated by the FCS Board or with respect to actins taken in contravention of this notice. Because such actions would be taken without proper authority, no indemnification would be permitted pursuant to the Association Bylaws.

Sincerely,

Roger L. Schlader, Chief Operating Officer and President.

STATEMENT OF HON. ROBERT T. STEPHAN ATTORNEY GENERAL OF KANSAS

As Attorney General of Kansas, I am the people's attorney. My role is more specific today as I share the concerns of a group of people engaged in my state's largest industry, agriculture. I am speaking as the farmer's attorney when I bring to your attention the concerns expressed to me through the conversations, telephone calls and letters I have had concerning the practices and policies of Kansas federal land banks and production credit associations, all members of the farm credit system.

At the outset, I wish to make it clear that I do not, as some have done, advocate the abolition of the farm credit system. The farm credit system as established by Congress was intended to serve the special needs of a unique industry, and those needs still exist. However, agriculture is always in a dynamic state, and it is therefore understandable and reasonable to expect that changes in the farm credit system may be necessary to insure that the basic purpose of the system is carried forward in light of today's crisis in agriculture. The objective and purpose of the farm credit system should continue to be, as it has always been, to serve its borrower/stockholders and to aid this country's agricultural producers "by furnishing sound, adequate and constructive credit and closely related services. . . ." 12 U.S.C. S2001(a). In order to fulfill this policy objective, the Farm Credit Act should "continue to encourage farmer and rancher borrowers participation in the management, control and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit. . . ." 12 U.S.C. S2001(b). When comparisons between the FCA and commercial banks are made, it is important to remember this language, by which the FCA was entrusted by Congress with a specific role in agricultural finance.

As the chief legal officer of Kansas, I have recently been advised of a number of complaints which have been raised by borrower/shareholders against the Farm Credit Administration and two of its components parts, namely the Federal Land Banks and Production Credit Associations. While these complaints fall into a number of areas (some of which are addressed by other attorneys general who appear as conferees), the most troubling concern in my view is the lack of "forbearance" which the system is showing to some borrower/shareholders who are in financial difficulty now, but who would still be viable producers if given the opportunity to restructure their agricultural operations. While no one denies the existence or the extent of the problems facing the system, it appears that some producers are being taken to foreclosure unnecessarily. This merely adds another element to an already tragic situation.

Farm Credit policy has long provided for borrower forbearance before the decision to foreclose is made. Curiously, however, the policy is an informal one, which both the Act and the Code of Federal Regulations silent on the point. The policy of forbearance is informally defined by the Ninth District (Wichita) as follows (this appears to be a representative definition of other districts as well):

> "Forbearance means to reach an agreement with a borrower as determined on a case-by-case bias, to renew, reschedule, defer payment, reamortize, refrain from initiating legal action against a borrower whose loan is in default, or any other option not enumerated that allows the borrower to make payments on the loan."

The policy goes on to say that, in determining whether to grant forbearance to a borrower, the following three conditions should be considered:

(1) Is the borrower cooperative?
(2) Is the borrower making an honest effort to meet the conditions of the loan contract?
(3) Is the borrower capable of working out the debt burden as determined by an appropriate credit analysis of the borrower's present and projected financial condition?

In keeping with this policy, before authorizing any foreclosure action a FLBA or PCA is supposed to consider, on a case-by-case basis, the above conditions for borrower forbearance. In the event the borrower refuses to negotiate in good faith on a plan for forebearance, or the borrower is not capable of working out of the debt burden, the association proceeds to take whatever legal action it deems appropriate to protect the interest of the instititution including, but not limited to, foreclosure.

In my experience, by-and-large problems do not exist with borrower/stockholders being unable to fulfill the first two elements or tests for forbearance consideration, namely cooperation and good faith. In fact, the cases brought to my attention demonstrate borrowers trying every possible method and means of preserving their agricultural enterprise. However, while there is generally not a problem with borrower/stockholders being less than cooperative or failing to do all they can to meet their financial commitments, the forbearance policy's third element (i.e. a plan deemed workable by the lending entity) is capable of being so broadly and arbitrarily applied that many deserving borrowers cannot meet its terms, given today's agricultural conditions and the events of the proceding years. Letters from farmers which serve to demonstrate this point are attached.

Based on the letters and complaints I have received, and on the experiences of other state attorneys general, I do not believe that the current forbearance policy is being uniformly applied so as to accurately reflect and intent originally expressed by Congress in the Farm Credit Act. To the contrary, documented cases exist which contain very troubling results. I would suggest that Congress closely examine the policy in a number of respects, with an eye to clarifying and strengthening it.

First and foremost, the forbearance policy is without a provision that grants a borrower/stockholder a means of review in an impartial forum when a forbearance request is denied. In addition, reasons for denial do not have to be expressed in writing, nor do specific terms which support the lender's action has to be given. The borrower is thus left in the dark about the basis for a decision that will probably cost him his livelihood.

In contrast, the Consolidated Farm and Rural Development Act, 7 U.S.C. S1981 et seq., (which is another legislative effort designed to assist agriculture,) provides the basis for a meaningful forbearance policy under the Farmers Home Administration. The forbearance policy in this act (as amended in 1978) provides:

> "In addition to any other authority that the Secretary may have to defer principal and interest and forego foreclosure, the Secretary may permit, at the request of the borrower, the deferral of principal and interest on any outstanding loan made, insured, or held by the Secretary under this chapter, or under the provisions of any other law administered by the Farmers Home Administration, and may forego foreclosure of any such loan, for such period as the Secretary deems necessary upon a showing by the borrower that due to circumstances beyond the borrower's control, the borrower is temporarily unable to continue making payments of such principal and interest when due without unduly impairing the standard of living of the borrower. The Secretary may permit interest that accrues during the deferral period on any loan deferred under this section to bear no interest during or after such period. . . ." 7 U.S.C. S1981a.

In finding that this language required the Secretary of Agriculture to implement a formal review upon request, one federal court has stated:

> "Congress intended to create a remedy or permit relief for certain borrowers for whom serious concern had been expressed because of repeated drought conditions and by reason of unusually low farm prices. These conditions created an urgent need and a particular form of relief was devised after extended study and debate. This was S1981a. The section contains the basic eligibility requirement, thus it requires that the applicant make the 'showing' that due to circumstances beyond his or her control 'the borrower is temporarily unable to continue making payments . . . without unduly impairing the standard of living of the borrower.' The Act provides that the Secretary may permit 'at the request of the borrower, the deferral. . . .' Thus the relief is only available if requested by the borrower." Matzke v. Block, 732 F.2d 799, 801 (10th Cir. 1984).

The language of the Farmers Home Administration statute reflects the awareness by Congress of the uncertainities that exist in agriculture today, and that circumstances beyond a borrower's control may prevent the possibility of maintaining current payments under the loan obligation. The Farm Credit Act should reflect this same awareness in a formal procedure by which forbearance can be requested (and, if denied, a basis given for the denial), for both laws deal with similar objectives, that being to provide financial assistance to agriculture. While I am not suggesting that the FmHA language be adopted verbatim for the FCA, this does represent a workable model for your consideration. Accordingly, I commend to the Committee the proposed draft legislation in this regard prepared by my fellow attorneys general.

Under current policy, only when an initial loan request is denied or reduced does an applicant have the right to know the reason for such action. 12 C.F.R. S614.4440. He or she may request a hearing by giving written notice to the association within 30 days of the original denial. 12 C.F.R. S614.4441. However, when a borrower/stockholder working under an existing loan becomes delinquent, a letter of foreclosure may be sent without notice of hearing, without regards to a past record of making current payments. Likewise, when a borrower's restructured plan or request for forbearance is denied, no formal hearing process of review is available. As such, the borrower is not afforded a chance to contest denial of forbearance, with the farm credit lender in the position to act as prosecutor, judge and jury. While federal courts have held that such treatment does not violate due process, due to the peculiar nature of the land banks and PCAs as "federal instrumentalities", this type of action offends fundamental notions of equity, and should be addressed by Congress as part of any relief package to the system.

Secondly, the policy for forbearance as currently applied may constitute an alternation of policy so drastic as to constitute a breach of faith with agricultural producers. As noted above, the third element of the forbearance test involves determining whether or not the borrower is capable of working out of the debt burden. This element invites abuses of discretion in the valuation of collateral and the determination of net worth and cash flow. When a land bank forecloses and takes possession of land that has dropped in market value by as much as 50%, the implication is that land will never reach the original loan value again, and that a loss is inevitable.

Such determinations are being made by the very same associations that recently encouraged borrower/stockholders to acquire 85% equity loans on land because they predicted that farmers had not yet seen the top on land prices and that agriculture has not yet begun to assume the debt load it was capable of maintaining. Now there has apparently been a change in the system's philosophy. An aggressive lending position has now become a conservative practice. Unfortunately, borrower/stockholders are not able to quickly reverse decisions and commitments made up to ten years ago when land values were up to three times the current prices. The need for relief is obvious. However, when an association determines the borrower/stockholder is not capable of working out of the debt, the borrower is far too often given no alternative other than foreclosure.

It would appear that in foreclosure no one really wins. The borrower/stockholder loses his land, his farm and a way of life as well as a way to make a living. The lending association is forced to sell land and assets often for a fraction of their loan value, as reflected in today's market price, in which case a significant loss is guaranteed. It would seem that losses could be minimized if in fact the borrower/stockholder was allowed and agreed to stay current in interest and to make payments on principle as conditions allowed. This would give borrowers the potential to continue in business, to restructure their operations and be afforded the chance that farm income levels will rise again so as to allow their debt obligations to be fulfilled. Even in worst case scenario, an association will always be in a position to obtain the land.

In one actual case, a farmer bought land 10 years ago for the market price of $1,000 per acres with the support and encouragement of a federal land bank. Today the market price for the same tract of land is $350 per acre. The farmer is delinquent, as crop prices as well as land prices have steadily declined. While he has attempted to make partial payments, or alternatively has offered to restructure his operations. If anything less than a full payment on both principle and interest is offered by the borrower/stockholder, the land bank has stated its intent to initiate foreclosure. In practical terms, this means the association is certain to suffer at least a $650 dollar per acre loss and the borrower/stockholder will lose the farm which represents both a way to make and living and a way of life.

I do not believe that borrower/stockholders are asking for debt forgiveness, nor do I advocate a moratorium on foreclosures. However, they are requesting, with justification, some patience, time and cooperation to reschedule and restructure their operations, and for fair and balanced treatment. They are asking for the FCA, an institution that was created to assist agriculture, to live up to that purpose. The system has now come to Congress and asked for assistance. Agriculture needs this system and the system needs your help. However, in giving such help, it is of paramount importance that you do not let the farm credit system lose sight of the purpose for its existence. The current policy of forbearance as applied is often no policy at all in light of the cases which I and other state attorney's general have seen.

In short, Congress is now presented with an unique opportunity to redirect the structure of the farm credit system so that legislative purpose can again be evidenced by its actions. Many concerned officials of the FCA have expressed the feeling that the answer to the problems in agriculture is not more credit, but more farm income. I could not agree more. Yet this statement does not address the real problems that exist today and that will continue to exist until the time when agriculture income does increase. The solution is not an easy one, nor will it be painless, but the pain can be minimized and should be evenly distributed among the farm credit system, the holders of farm credit bonds, and the farmers and ranchers who comprise the owner/borrower element of this system of agricultural financing. Like the lenders and investors, farmers and ranchers accepted a risk, and again, they are not asking for debt forgiveness. You have to understand the psyche of agriculturalists to know why people ask for the opportunity to stay on their farms for the rest of their lives and still possibly never become debt free. This alone is quite a price of pay. If a fair policy for forbearance cannot be devised to allow them a chance to survive, the result is an enormous injustice that defies the purpose and objective Congress intended when the farm credit system was created by the Farm Credit Act. I ask this body to again act with agricultural producers' best interests in mind, for history has shown this to be our country's best interest as well.

[Case 1]

August 28, 1985

Attorney General
Robert Stephan
Kansas Judicial Center
Topeka, Kansas 66612

RE: Violation of Federal Enabling Legislation by Federal Land Bank of Wichita

Dear Mr. Stephan:

I represent two farmers who have had foreclosure proceedings initiated on them by the Federal Land Bank of Wichita. It is my opinion that the Federal Land Bank, in both of these situations, is violating their Federal Enabling Legislation, specifically the Federal Farm Loan Act of 1916 and the Farm Credit Act of 1971. My clients are _______________, a rural _____________ County farmer, who missed a land bank payment in April of 1985. The Land Bank payment was due April 1, 1985. This is the only payment he has ever missed to the Federal Land Bank. Prior to that time, we met with local Land Bank officials to disclose to them that we were unable to make the payment and to attempt to work a compromise solution. The Land Bank Association to date has no conveyed to us any offer whatsoever on how to solve this matter. Their only solution and answer to us was to file foreclosure proceedings on June 19, 1985, approximately two a half months after we first met with Land Bank officials to tell them of our inability to make this payment. The Land Bank officials made no attempt whatsoever tow work out any compromise solution or to review the situation in depth. We made them an offer of how to settle the matter, which was rejected out of hand by them. I believe that this is not in compliance with the two aforementioned statutes which gave life to the Federal Land Bank.

A second client of mine is _____________, a life long farmer in the rural _____________ area, __________ County, Kansas. Mr. and Mr. ___________ are hard working farmers in that area, who in November of 1984, where only able to make one half of their Federal Land Bank payment. This is the first time they were unable to make a full payment to the Federal Land Bank Association. The Federal Land Bank answered the ______________ attempt to make payment with a notice of foreclosure letter. Since that time, the ____________ have retained my services and we have worked with a computer program at Kansas State University, attempting to determine what portions of the farm enterprise are profitable, which are not, and how the enterprise can be restructured to make it overall profitable. During this time period the Federal Land Bank Association has foreclosed, filing their foreclosure proceedings May 15, 1985. A conference was held with a commercial creditor of the _____________ and the Federal Land Bank Association in early August of 1985. At that meeting the Commercial Ceditor stated that they would work with the __________ in attempting to restructure the farm, ti keep him in farming and to give to the bank the best possibility of receiving their money back. The Federal Land Bank Association received our plan for restructuring and one week later dismissed is out of hand. Their counterproposal was basically give up everything. Their counterproposal gave the ________________ absolutely no incentive to settle because the ______________ would actually receive more if the foreclosure action went all the way through then if they accepted the settlement offered by the Federal Land Bank. In other words, it wasn't a settlement at all.

In both of these cases the Federal Land Bank is not complying with the afore mentioned statutes. The farm credit system was set up to assist farmers, particularly in hard economic times, to work with the farmers who own the farm credit system. Particularly, in the _____________ situation, we have found the commercial bank to be far easier, understanding and willing to work with the ___________ the Federal Land Bank! This is not the way it should be, nor the way Congress intended for the Farm Credit System to act. Therefore, my clients agreed to seek and request that your office investigate this situation to determine if the Federal Land Bank is complying with Federal Statutes. Again, the names and addresses of the individuals involved are:

Thank you very much for your assistance.

Sincerely,

________ ___________.

[Case 2]

September 26, 1985

Our annual payment is, and has been, in excess of $50,000 to the Federal Land Bank, depending on the rate of interest they charge. This December 1, 1985, it will be $56,300. We still owe $26,000 on last year's payment.

We needed approximately two more weeks to sell our cattle so that we could make the final payment. We were given three days, and then the FLB sent a notice of intention to foreclose. For the past three years we had been behind on our payments, and they had accepted late payments. Our note with them was for $450,000.

There are 1440 acres of land involved including our home. Approximately 500 acres are farmland, and 940 acres are pasture. If FLB could rent the land for the following figure, they would receive:

Figures are Farm Management's estimate:	500 A. farmland at $30 per acre	-$15,000
	940 A. pasture at $10 per acre	-$ 9,400
	Buildings at $3600 annually	- 3,600
	Total to FLB	$28,000

FLB would have to pay taxes of (1984 figures)	3,167
Insurance, approximately	1,000
$28,000 minus $4,167 leaves	$23,833

FLB would be responsible for spraying musk thistle, bind weed, upkeep of fences, terraces, and buildings.

FLB say the land is now worth only $130 per acre. ($200 for farmland, and $100 per acre for pasture.)

1440 A. X $130 is $187,200--value of land according to FLB.

When FLB takes over land they will not receive any interest.

During the past 10 years we have paid them over $300,000. Most of this has been interest because we have lowered our note only $14,000, approximately.

In six more years we would pay them over $300,00 more and would still have to pay them for over 20 more years.

We have more then enough life insurance to cover our indebtedness to them.

Even a one-half payment would equal more than they can realize from foreclosure.

To us Federal Land Bank foreclosure does not make common sense.

[Case 3]

My personal history with Federal Land Bank follows:

I got behind on my Federal Land Bank payment in 1983, because the fall of 1982 was toowet to plant wheat. I have seen making monthly payments and would have been current in 1984 if it hadn't been for the disaster which took my soybean crop. Attached is a sheet showing the payments I have made.

In April 1985 Federal Land Bank wanted me to start paying $800.00 a month. I made one $800.00 payment and tried to explain to them I couldn't handle that much with trying to get crops in for this year.

In February 1985 I applied for an SBA Economic Injury loan. I have been turned down twice by SBA because of payback ability. I have reapplied a third time and Congressman Bob Whittaker has also written them to try to get it passed this third time. We found out the main reason they're turning down was because Federal Land Bank told them they were going to start foreclosure proceedings. We've tried to get this straightened out with SBA and Federal Land Bank wrote them a letter stating that they would not foreclose if we were brought up current and could prove cash flow. But Federal Land Bank has not even waited for their reply to our third reconsideration on October 4, 1985, we were served our papers on the foreclosure.

Over the phone, I was told that they would not accept any more payments, because they wanted the full amount. My attorney advised me after that not to send them any more money, that if they intended to foreclose anyway it would just be money wasted if they did accept it. I was also told that after they foreclosed and my farm came up for sale I would not be permitted to buy it back.

In September I talked to them and asked if they would hold off foreclosing until I got my 1985 crops harvested, so I could bring them up current and have my loan reinstated. They said they wouldn't wait.

I also sent them the last part of September a copy of my reconsideration to SBA, a letter from Bob Whittakers office, and a cash flow study from Kansas University Extension office. Then a little over a week later I'm served with my foreclosure papers.

In my opinion they're not even helping the farmers. They were organized in the first place for the farmers, but now all they seem to want is all of the farmers land. something should be done with Federal Land Bank's system before all your family farms are gone. If it comes to big corporations owning all the land, everyone will suffer. There will also be a lot of families on welfare. With the unemployment the way it is now and you take all your farm families and put them in the cities to work, its just going to make the situation worse.

Federal Land Bank also keep raising the interest rate, so that the farmers that are in trouble don't have a chance. As I stated in the beginning I also own a farm implement business, and this gives me the opportunity to talk to a lot of farmers. Even the farmers that are in good standing with Federal Land Bank say they are looking for other places to refinance, because of the interest rate. As it is set up now, if you happen to get behind you end up paying over $5 more than when you were in good standing.

What I ask from Federal Land Bank is consideration to let me have a chance to raise a crop and pay on my loan. Even though I am behind in payments I also have had a couple of bad years that caused it. Farm income has been at its lowest since I have been farming (20 years). I have in the past been able to make it through some hard times, however, the drought and early freeze in 1984 caused enough damage that Crawford County was declared a disaster. Soybeans averaged 10 bushel per acre, (the ones that were harvested) however there were uncounted acres that were diced up. I know this to be fact because of customers I talk to.

I have told and asked Federal Land Bank to give me some extra time because I feel that I can overcome the condition I am in, but it seems they have made up their mind to foreclose event though I want to hold on.

[Case 4]

August 1, 1985

C/O Children's Mercy Hospital
1710 Independence Ave.
Kansas City, Missouri 64106

This letter is in regards to your delinquent payment on Federal Land Bank Loan No. ________. It was our agreement that we would continue our work along as long as half of the delinquency, approximately $26,200.00, be applied to the loan on or before August 1, 1985. We both realize that with the amount of wheat available for sale, and the inability of your short-term lender to provide assistance, you won't be able to meet the work along requirement.

Our Association intends to assist borrowers through appropriate servicing actions. In considering borrower forebearance, we look at four (4) important points:

1. Is the borrower doing his honest best? Are reasonable management practices and resources being used in the operation?
2. Is the borrower applying the proceeds of production, above necessary living and operating expenses, to the payment of debt?
3. Is the borrower taking proper care of the security?
4. Does the borrower have a reasonable chance to remain in agriculture over the long run?

We ask that you realistically assess your position in relation to our forebearance policy. We feel that your operation does not have a feasible chance to remain in agriculture. Your inability to service your long-term obligations the past 28 months would suggest that we cannot wait any longer for something to happen. With the past 28 months of accrued and default interest, your loan does not have a sufficient collateral margin to allow a continued delinquency.

At this time we are requiring your loan to be paid in full. If your short-term lender cannot assist you in getting your loan fully current, then we would consider negotiating a direct deed of the security to satisfy the obligation. As a final alternative we will pursue legal foreclosure of your loan to satisfy the obligation.

This office will begin processing the foreclosure immediately after the August 1 deadline is not met. We will discuss with you other alternatives when you are back in this area, but unless an agreeable plan can be arranged, we will continue the foreclosure.

I ask that you contact this office at your earliest opportunity to discuss any questions or to schedule a personal appointment with ___________ our litigation officer, to discuss direct deed as an alternative to foreclosure.

Respectfully,

Loan Officer.

Nothing contained herein shall operate in any way to change or modify the terms and conditions of the Federal Land Bank's note and mortgage, or to affect the validity or priority of the note and mortgage as a first lien upon the real estate covered thereby.

[Case 5]

October 14, 1985.

Dear Mr. Stephan:

After reading the High Plains Journal, October 7, 1985 issue, I felt a need to contact your office. The article was about the farm credit crisis and the Farm Credit System.

Our situation is quite similar to some of the things talked about in the article. Our short term lender is the PCA in ________, Kansas. In January of this year we were told by our loan officer at PCA that our credit line would be reduced to living expenses and money needed for crop production and harvesting, but no funds would be loaned to make our land payment to the Metropolitan Life Insurance Co. We were told that if our wheat harvest would come in above the PCA's projected yield we may be allowed to make our land payment. Wheat harvest is since past and it will probably be the best we will ever have, still no funds to make our land payment. when the weather clears we will be starting on our fall row crop harvest which should be another large crop but no funds will be released from it to make the land payment. We have been in contact with the loan officer from Met. Life since January keeping him informed as to what is taking place.

What our question is, with PCA having a lien on all of our crops, what can we do to get our land payment current? The what crop has been sold and turned into the PCA and the fall crop will also go to them. Value of these crops should be around $240,000.00 and the land payment is about $34,000.00. Met Life informed us this week that if a sale of our land or payment isn't made soon, they have no other choice but to force the sale or foreclose.

I know we need to reduce our short term debt but without the land to generate income what chance do we have to survive this crisis? We need to know what our rights are in a case like this. Being caught in the middle between the two lenders is very stressful situation when we have the income to keep our land payments current but no way to make them.

I would appreciate hearing from you with any information that could help figure this out. Please let me know what I can do and if more information is needed from me feel free to ask. Thanking you for an early reply I remain.

Sincerely yours,

______________ ____________.

[Case 6]

September 26, 1985

Supervisor - Twelfth District
Farm Credit System
7940 West Kellogg Drive
Box 12800
Wichita, Kansas 67277-2800

Dear Mr. ______________:

Please consider this letter in the form of a complaint as to the handling of the captioned matter by officers and officials of the Federal Land Bank Association, __________, Kansas. Since May of 1976, __________________ as principal, and his corporation, ---------------- have timely and consistently serviced a loan from the Federal Land Bank in the principal sum of $393,000.00, payable in thirty-three annual consecutive installments. At the time these documents and transaction were consummated, Mr. ___________ was advised that the loan could be renegotiated or reamortized upon his request. Because of these severe and depressed farm economy, Mr. ___________ was unable to pay this past annual installment in a timely manner. Despite the fact that for the past nine years Mr. ______________ has paid $107,181.00 on the principal debt, as well as accrued interest in an amount of $130,542.41, and notwithstanding the fact that he has requested that the loan be reamortized, the Federal Land Bank Association of __________ is intent upon ignoring his past service record and his request, and proceed with foreclosure. Mr. ___________ has requested that the ranch be reappraised to reflect current market conditions and the indebtedness to the Federal Land Bank reevaluated. If this alternative was not acceptable, Mr. ___________ has indicated to officials at the Federal Land Bank that he is seeking to find alternative financing. These request and/or alternatives, as suggested by Mr. ______________ has apparently been ignored by officials of the Federal Land Bank Association, as it is their apparent intent to foreclose forthwith.

Another problem which Mr. _________________ has encountered, indicating the attitude of the officials at the Federal Land Bank of ____________, involved partial release of the mortgage as to ten acres, which the Association agreed to by letter February 15, 1985, to Mr. _____________ from __________. Mr. ____________ was causing certain improvements to be made upon the ranching premises and had secured a loan from the Farmer's Home Association to perform certain improvements on a residential structure. The Farmer's Home Administration required a release as to these improvements and surrounding 10 acres. Mr. ____________ completed Form 6338 of your Association and submitted it along with his check for $50.00, dated February 22, 1985, to Mr. __________. Based upon the Association's letter of February 15, 1985, from Mr. ____________ and the loan commitment from the Farmer's Home Administration, the ______ National Bank here in __________ relied upon these documents to temporarily advance monies for these farm improvements, which were to be repaid upon consummation of the Farmer's Home loan. Since that time the Federal Land Bank Association has apparently changed its attitude and is now reneging upon its agreement with Mr. ___________ to release this ten acres. This places Mr. ___________ in a very adverse and detrimental position with the Farmer's Home Administration, and with his local bank, all of which relied upon documents issued by your Association, as well as numerous conversations.

In conclusion, Mr. ________ is of the opinion that he is not being treated fairly or equally, or in accordance with representations previously made by your Association. He is demanding that this matter be reviewed by your office and is certainly willing to meet with an official of your office to discuss these matters upon your request.

Yours truly,

________ ____________,
Attorney at Law.

STATEMENT OF KY P. EWING, JR. ON BEHALF OF GRASSROOTS: THE NATIONAL ASSOCIATION OF FARM CREDIT SYSTEM STOCKHOLDERS AND THE FEDERAL LAND BANK ASSOCIATIONS OF TEXAS STOCKHOLDERS' DEFENSE FUND

My name is Ky P. Ewing, Jr. I am a partner in the law firm of Vinson & Elkins and appear today on behalf of Grassroots: the National Association of Farm Credit system Stockholders ("Grassroots") and on behalf of the Federal Land Bank Associations of Texas Stockholders' Defense Fund ("Defense Fund"). Also present are Mr. Luman Holman, Executive Director of Grassroots, and Mr. Don Neal, Chairman of the Defense Fund. 1/

1/ Mr. Luman Holman is a farmer, banker and lumberman from Jacksonville, Texas, who is on the Board of Directors of the Tyler Federal Land Bank Association (and its former chairman).

Mr. Don Neal is a rancher and former banker from Rochelle, Texas, who is a shareholder in Cattlemen's Production Credit Association, a director of McCulloch County Electric Cooperative, a former Chairman of the Board of the Farmer and Ranchers Cooperative of Brady, Texas, a Director and Chairman of the Brady Federal Land Bank Association, and a Director of the Texas and Southwestern Cattle Raisers Association. Mr. Neal currently serves as Chairman of the Stockholders Advisory Committee of the Federal Land Bank Associations of Texas.

Grassroots was organized by farmer/rancher borrowers of the Farm Credit System and has representation from 10 of the 12 Farm Credit Districts. It is composed of PCA people, Land Bank people and people interested in cooperatives. The Defense Fund represents farmer/rancher borrowers from 42 of the 44 Land Bank Associations in Texas.

The aim of these shareholder organizations is to reflect directly to the Congress and the Administration the views of shareholders of the system. They want to help the system stay alive in today's difficulties and restructure itself to carry out its essential farm credit functions in a more efficient and responsible manner, while preserving the equally essential local control and management of a truly cooperative system.

At the bedrock of shareholder concerns for legislative change are:

(1) local control by farmer-rancher borrowers through boards of directors of banks and associations elected by and accountable to each institution's shareholders,

(2) the restructuring of the Farm Credit Administration into a true regulatory agency, with the elimination of its loan promotion and management activities and powers, and

(3) returning the system to its essential banking elements in a way that will restore confidence in the system, with on the part of farmer-rancher borrowers and on the part of the capital markets to which the system must go for its money.

In an attempt to contribute responsibly to debate on needed legislative change, these shareholder groups have met with high officials of the Administration, the Agriculture Department, and the Office of Management and Budget, with high officials of the Farm Credit Administration, with numerous representatives of the 37 banks of the system and the Farm Credit Council, and with other national farmer organizations.

After obtaining as much information as we could on the financial condition of the farm credit system, as well as on the difficulties it faces, and after a thorough review of the structure and mechanisms now in place in the system, the shareholder groups prepared a legislative package that contains what we believe are essential elements of reform. These are essential elements if we are to restore confidence in the system on the part of the shareholder-borrowers and on the part of the capital markets. Additional elements my be needed, but we believe that the ones I will outline in a moment are necessary elements if the Congress is to help the system restructure itself in the best way. The package does not ask for federal assistance from the Treasury of Federal Reserve Banks; in our view, the changes we are proposing are essential preconditions which should be put in place before anyone seriously considers pouring federal tax dollars into the farm credit system.

As we view it, we are dealing with a $75 billion system that will probably sustain several hundred million dollars of operating losses in the aggregate in this calendar year, but that still has a lendable net worth approaching $8 billion, some $5.3 billion of liquid investment securities and cash, and sufficient assets in the aggregate to allow the system to go forward in helping itself through the next several months of difficult time, _if_ they are properly managed and _if_ capital market and borrower confidence in the system can be restored by legislative reform. 2/

I. Outline of Shareholder Proposals for Legislative Reform

While we believe that the overall condition of world markets and the agricultural economy in general have clearly played a major role in the difficulties now faced by the Farm Credit Banks, we as shareholders also recognize that in the future the system must have:

(a) better decisions at the local level,
(b) better and truer regulation of its banking activities at the national level, and
(c) better mechanisms for using the assets and reserves of the system to insure against the illiquidity and impairment of capital at any one institution of the system.

Our legislative proposal directly addresses each of these basic problems. In addition, it gives new tools to the local associations, and to the regulatory, to allow them to help more in making the farm credit system's contribution to the overall solution of our agricultural problems.

In brief outline, the shareholders' proposal would make the following legislative changes:

A. Local Level Governance Changes

1. Give each of the 36 banks in the system its own five-member board of directors elected by the shareholders of that bank (leaving the Central Bank for Cooperatives unchanged).
2. Make the district farm credit boards advisory and reduce the number of directors to five: one from each of the three bank boards and two elected directly from the farmer-rancher borrowers.
3. Require use of generally accepted accounting principles (GAAP accounting) by the banks and associations in the system, require certified public accountant audits at least yearly, and require publication of the financial statements of each of the banks and associations.
4. Restore to the banks and associations management responsibility, by returning to them most of the "prior approval powers" now vested in the FCA.

B. Reform at the National Regulatory Level

5. Create a Federal Farm Credit Insurance Corporation ("FFCIC") with a three-member board appointed by the President with the advice and consent of the Senate, which would have:

2/ See the Financial Statements of the 37 Farm Credit Banks for the period ended September 30, 1985, released on October 23, 1985.

(a) cease and desist powers against unsafe and unsound agricultural banking practices,

(b) a fund created by an initial transfer of reserve assets from present system institutions to the FFCIC in exchange for non-voting shares (with a $2.3 billion initial transfer, plus provision for additional assessments if necessary), and

(c) the responsibility to insure the 37 banks and the existing associations against illiquidity and against impairment of capital, through use of the fund, by means of loans, grants or guarantees to system banks and associations, but with ultimate responsibility to liquidate system institutions (as a Congressionally disfavored last resort) in order to avoid severe impairment of the FFCIC fund.

6. Eliminate non-banking activities from the Farm Credit System, leaving in place the 37 banks, the existing land bank associations and production credit associations and the Federal Farm Credit Banks Funding Corporation.
7. Statutorily prohibit forced merger of associations or banks (while retaining the right of associations voluntarily to propose mergers of like associations).
8. Make the Federal Farm Credit Board advisory, with its chairman to be appointed by the President.
9. Sunset the Farm Credit Administration (having (a) returned much of FCA's "prior approval" involvement in management to the banks and the associations, and (b) transferred to a new FDIC type regulatory/insurance agency FCA's residual regulatory power).

C. Added Tools to Help Agriculture

10. At the FFCIC level: statutorily permit the FFCIC to lower the capital requirements for system institutions across the board to not less than 1/2 of 1 percent more than the capital requirements applicable to national banks.
11. At the Local Bank and Association Level: Grant authority to the primary lending institutions in the System, as an alternative to foreclosure, to take title to collateral and lease it back to the debtor, or other viable operator, with the value of the collateral to be includable in the statutory collateral requirement for the issuance of bonds, this function to be specially subject to regulation by the FFCIC which may charge differential premiums in connection with risks growing out of this function.

D. Transition Provisions

12. Provide appropriate transition provisions including (a) an effective date for sunset of FCA and creation of FFCIC ninety days after enactment, (b) continuation of FCA regulations for a temporary period of six months or until promulgation of interim of final FFCIC regulations, whichever is earlier, and (c) asset transfers to FFCIC from sunsetted entities.

We have put the concepts just outlined into statutory language and have submitted to the Members of the Committee our proposed changes in bill form. We have also submitted to the Members of the Committee those changes incorporated in the Farm Credit Act of 1971, as amended, with deletions shown as strikeouts and additions shown in italics.

The Shareholders' Legislative Proposal was introduced in the Senate as S. 1790 by Senator Max Baucus of Montana on October 25, 1985.

The remainder of this statement attempts (a) to discuss each of our legislative changes in greater detail, (b) to comment on other basic models for change being suggested to the Congress, and (c) to comment on possible federal assistance packages.

11. Discussion of Shareholder Proposal

A. Reform at the Local level

Our Shareholder proposals will keep the present basic structure of the Farm Credit System, with its 37 banks and its existing land bank and production credit association. Joint bonds would continue to be issued to raise money from the capital market, and local decisions would continue to be made for lending to farmers and ranchers for long-term and short-term agricultural credit needs.

Our changes in the local corporate governance provisions, however, would correct some very basic defects that have contributed to the current financial difficulties of the system. Today Land Bank, FICB, and BC assets are being managed by boards of directors that are not elected by the shareholders who own those assets. For example, for any given Land Bank, its shareholders can elect only 2 out of the 7 people who are responsible for managing the bank's assets as its board of directors. Similarly, production credit associations, which are the primary lenders in that segment of the system, are not now required to have their accounts audited by certified public accountants, have not previous to now been required to use generally accepted accounting principles (GAAP accounting), and are not required to publish their financial statements for the intelligent benefit of their shareholders.

Some have characterized the present situation as being one in which those with power are really responsible to nobody. For many shareholders it is always the amorphous "they" who make the decisions, including the loans, but who cannot be voted out of office. Furthermore, under today's statutory arrangements, the incredible number of "prior approvals" of management activities by FCA means far too much deference being accorded to the views (and indeed the whims) of FCA officials who in the past few years clearly have engaged in too many loan promotion activities.

From 1916, when Congress created the Federal Land Banks, until the 1971 amendments to the Farm Credit Act, local control was the heart and soul of the cooperative Farm Credit System.

The people who are the foundation of the system's strength, the farmer and rancher borrowers whom the system was established to serve, are supposed to have a say in the governance of the system, but today their voices are not being heeded by the so-called "leadership" of the system.

Under the situation that now exists, the group of seven people who comprise each District Board is deemed to constitute three separate boards of directors for the three banks in each district. Tow members are selected by the land bank associations, two by the production credit associations, and two by the cooperatives. In addition, the governor of the FCA (supposedly the system institutions' regulator) appoints one member of each district board. The mischief under this arrangement is that the borrower shareholders of a given bank are never represented by more than two-sevenths of the directors of their bank. Under such governance procedures the borrowers are effectively disenfranchised. A majority vote of the board can always be obtained without the participation of anyone who is accountable to the bank's shareholders, regardless of the number of shareholders or the relative stock ownership they represent.

While the approximately 100 people who today inhabit the upper reaches of the system -- the officers and directors of the 37 banks -- continue to give lip services to the idea of local control, they have in fact been moving the system in a different direction. You have only to consider their $5 million "Project 1995" to see where they are going. In the Phase III Report setting out their conclusions, they declared the demise of the cooperative movement and the necessity for a "Central Entity" that would be a super-bank holding company through which all of the $75 billion of assets in the farm credit system's individual institutions would be managed.

Lest anyone be misled into believing that the Phase III report of Project 1995 is simply star-gazing, let me respectfully point out that the "leaders" of the system have already incorporated the Central Entity, with articles of incorporation and by-laws so written that practically anyone could run a major bank holding company out of the real set-up. They are now actively seeking a person for the Chief Executive Officer job at a salary of $450,000 to $500,000 annually. Under the already existing articles and by-laws, the 13 directors of that "Central Entity," -- not a single on them directly elected by any shareholder in the system -- plus that highly paid CEO (perhaps with help of an in-house general counsel), can at any time vote themselves authority to determine how the system goes to the capital markets for money, how that money is lent to farmers and ranchers, an all details of the personnel actions and compensation levels to be taken by all of the System's institutions -- by what will, in fact if not in their press releases, be merely the subsidiaries of this national super-bank "Central Entity" holding company.

Furthermore, you can also see where the 100 or so "leaders" of the System are headed when you consider their almost frenzied efforts to liquidate associations, with resulting loss of shareholder stock, and to coerce massive mergers of system institutions -- matters that, as you are aware, have caused widespread political unrest. The shareholders believe they have been treated in a most heavy-handed manner.

The shareholders do not believe that Congress ever intended to create, either directly or indirectly, a super, national "Central Entity" agricultural bank. To the contrary, Congress has consistently since 1916 mandated a decentralized, locally controlled system. We are certain that if the confidence of the farmer-rancher borrowers in the stability of the system is to be restored, and if sound and knowledgeable lending decisions are to be obtained in the future, Congress must act to set matters right.

If discipline is to be imposed on the crucial local lending decisions by the institutions in the Farm Credit System -- and we believe as shareholders that greater discipline must be exercised -- then the Congress must make basic corporate governance changes in the statute. If local control is to have meaning for the Farm Credit System rather than being a mere buzzword, accountability of directors to the banks' borrowers must be restored.

We believe that mandated accounting statements, certified public accountant audits, and publication of financial statements are necessary if shareholders are responsibly to exercise local control over the people who lend the system's money. Even more important, shareholders of a given institution must elect all of the directors of the institution. To put the matter colloquially, only when shareholders can in fact "vote the bums out," on the basis of real knowledge of what is going on, is there true corporate democracy and effective discipline.

Our proposals put corporate responsibility and accountability where it belongs and also return to the shareholders that portion of FCA's power that has caused it so disastrously to intervene in loan portfolio management.

B. Reform at the National Level

At the national level, after sending bank management-type powers back to the shareholders, our proposal addresses the fundamental problem, which is that the regulator has not had enough effective tools to work with.

It is seldom that shareholders in private institutions suggest to the Congress that a federal regulator be given greater powers. And indeed the commercial banking world views the current exercises of power by the Controller of the Currency in the regulation of banks to be more officious and more arbitrary than they think appropriate. Nevertheless, the shareholder groups, on whose behalf this statement is made, advocate to the Congress the creation of a Federal Farm Credit Insurance Corporation, similar to the Federal Deposit Insurance Corporation, and propose cease and desist powers that can be directed to each bank in the system, to each association in the system, and to their officials. The cease and desist powers are designed to be used against "unsafe and unsound agricultural banking practices" that would directly affect an institution's financial stability or that would cause a disbursement of funds by the insurance agency. This incporates the judicial interpretation of similar cease and desist powers in First National Bank of Bellaire v. Comptroller, 697 F.2d 674 (5th Cir. 1983), modified to reflect the fact that we are here dealing with agricultural banks. In short, while we advocate real cease and desist powers, we have tied their use to a reasonable standard to which the courts have given ample content in the commercial banking world.

Again on the model of the FCIC, our proposal would make the FFCIC responsible, to the extent of its fund, for insuring each of the system banks and associations against illiquidity and impairment of capital. It would be responsible for doing this by means of guarantees, loans, grants and the purchase of non-voting securities. It would not be a warehousing organization for non-performing loan portfolios. We think such loans can best be serviced by local people who know local situations.

We have chosen the standard for action by the FFCIC to aid system banks and associations after analysis of the nature of the insolvency-type problems confronting portions of the system. Persons familiar with bankruptcy principles will appreciate that there are two basic types of insolvency: (a) where an institution's liabilities exceed its assets, which by definition produces a negative net worth or capital impairment, and (b) where an institution is unable to meet current obligations when due, which is a liquidity crisis that any or may not also involve the other type of insolvency. By allowing the fund to be used by the FFCIC both to correct or stave off impairment of capital, and also to deal with illiquidity, the FFCIC would be given the flexibility to tailor its response to the particular difficulties being faced by a system institution.

We have also provided, as a "Congressionally disfavored option exercisable only to prevent severe impairment of the insurance fund", that the FFCIC will have the power to place a bank or association in receivership and to liquidate it. Again by analogy to the world of bankruptcy law, only if reorganization is truly impossible would the FFCIC ever have an incentive to liquidate an association rather than to try and let it work out its difficulties. Yet the ultimate discipline of liquidation would be available as a tool that, in extreme cases, could be used by the regulator. The liquidation powers are patterned after those of the FDIC in 12 U.S.C. S1821(d).

The FFCIC would not have authority to force a merger, but is expressly given authority to review voluntary mergers proposed by associations, and is required to approve such voluntary mergers unless "the Corporation can establish that much merger would result in a non-viable institution within the system or would lessen the long-term financial stability of the System."

We believe that the insurance provisions must be read in conjunction with the cease and desist authority, the removal/suspension authority, and the receivership/liquidation authority. Together they establish a regime under which a system institution's financial difficulty creates full authority in the FFCIC to mandate changes in the practices of the institution and to suspend or remove directors or officers, if necessary, while at the same time making mandatory on the FFCIC that it use the insurance fund to correct the difficulty. We intend, in all but the most extreme cases, that the FFCIC be required to reform a troubled system institution while retaining it as a system entity to serve its geographical territory.

With this combination of responsibility and power in a new FFCIC, we believe that the strongest of the system's borrowers will have less reason to leave the system than they do now, under the present fear of increasingly wide-spread liquidation of system institutions. Similarly, we believe, once the capital markets realize that the best borrowers in the system have been given incentives to stay, while a new regulatory agency has also been given power to deal in a direct manner with difficulties, that the capital markets will also be reassured.

As to the fund of the FFCIC, we have given it the power to charge premiums based on the loan portfolio volume of each system institution. In addition, as an initial means of large-scale funding, we have provided for a Congressionally mandated transfer of liquid assets from each system institution, as a percentage of each prime lender's loan portfolio. Depending upon what Congress determines to be the appropriate funding level, shareholder groups would favor an immediate transfer of 3 percent (which would produce $2.3 billion). It is our understanding that (a) from an accounting perspective the system institutions have reserve accounts exceeding these amounts in the aggregate, so that a transfer of this general magnitude could be made, with non-voting share of the FFCIC to be held as assets in place of the reserves, and (b) from the liquidity viewpoint, there will be adequate funds to make such a transfer. As of September 30, 1985, according to the Financial Statements of the 37 banks released October 23, 1985, there were $5.5 billion in "investment securities and cash." If any given system bank or association would have difficulty making its initial payment, adjustments or deferred obligations could be authorized.

Overall, our proposed FFCIC would have a fund-to-loan portfolio ratio of 3.0%. By comparison, the FDIC at the end of calendar 1984 had a fund-to-insured deposits ratio of 1.23% ($17.2 billion fund to insured deposits of $1.4 trillion).

The aim here with the proposed FFCIC is to Congressionally mandate that the farm credit system first use its own reserves in an efficient and responsible manner to buttress its own institutions.

In our effort to demonstrate both to the farmer-rancher shareholders who are the borrowers in this system, and also to the capital markets, that have also proposed that the system get back to basics and eliminate all of its non-banking activities. We do this by redefining the elements of the system to be the 37 banks, the existing associations, and the Federal Farm Credit Banks Funding Corporation. We eliminate and liquidate all the other service corporations, transferring any net assets they may have to the FFCIC to augment the insurance fund. The proliferation in recent years to corporate entities, ostensibly providing one kind of service or another to system institutions (rather than having those institutions rely on the competitive market to supply these services) may well have siphoned real dollars out of the system. In any event, the proliferation of these corporations has recently confused people and undermined the credibility of the essential parts of the Farm Credit

System. As part of our overall reform, we eliminate these various service corporations.

Also as part of the reform at the national level, we make the Federal Farm Credit Board advisory only, with it chairman to be appointed by the President.

Having returned much of the Farm Credit Administration's "prior approval" authority back to the banks, and having transferred its regulatory power to the Federal Farm Credit Insurance Corporation, we propose the sunset for the Farm Credit Administration.

C. Additional Tools

We propose two additional tools to aid the system in meeting the present agricultural crisis.

First, the FFCIC would be given the power temporarily to reduce the statutory capitalization requirement of system banks, now set in the Act at 10 percent, to a level not less than 1/2 of 1 percent more than the capitalization requirement fixed for national banks. Today, national banks have a capitalization requirement of 5.5 percent (ratio of primary capital to total assets). While the authority, if used, would tend to create more leverage in the system, we believe that, as part of a package of reform, it is not unwise to give added flexibility to the regulator/insurer to deal with the current situation.

Second, the leaseback authority which the shareholder proposal would give to the primary lenders in the system -- the PCAs in that portion of the system and the Land Banks in the other portion of the system -- would attempt to address a more fundamental problem. At present, land values are falling through out most of the country, in some states quite precipitously to levels less than 50 percent of what they were just a few years ago. This reflects the fact that there is an oversupply of land reaching the market: too much land is chasing too few buyers. At present, when a borrowers defaults to a farm credit system institution, there is normally a foreclosure and sale of the collateralized land or farm machinery. If even a portion of the land or farm collateral that would otherwise thus be forced into the already super-saturated market could be held off the market, it would assist the situation, provided the mechanism for doing so is not merely a band-aid that prolongs an intolerable situation.

To the extent that the farm credit system's institution have lent money on farming operations that are not, and cannot be made, viable at today's commodity prices, it will be better fo the system to take its lumps on defaulting loans, to foreclose and to put the collateral on the market to bring whatever can be received for it. But there are also many farming operations, on which system institutions have lent money and where the borrower is in default, that can viably be continued at today's commodity prices -- in short, there is land and there are farmer that will produce future streams of income at current commodity prices sufficient to service the debt needed for the farm operations.

If this land other collateral could be kept off the market, and the original farmer-borrower or other new viable operator could be kept on the land, we would have solved an important portion of the problem. The key is to make certain that the decisions are made locally about what farming operations are viable. We believe that the proven achievements of the local Production Credit Associations and the Land Banks (through the Land Bank Associations) make them the logical choices, and by far the least costly choices, as the agencies to make these decisions in the current agricultural crisis.

The shareholder proposal would place on the local associations (in a reformed world in which the directors of the banks could be voted out by their own shareholders and in which they must operate with published financial reports using generally accepted accounting standards) responsibility for making the hard choices, in default situation of (a) whether the land could produce streams of income at current commodity prices sufficient to service the debt, and (b) whether the debtor or some other viable operator should be selected to whom the farm could be leased back. If the land is leased by the original debtor, the shareholder proposal would give the debtor the right of first refusal to repurchase the land or other collateral from the system institution at a price to be determined and negotiated between them in the future. If the leaseback is to other than the original debtor, no such right of first refusal would be involved.

The proposal comtemplates that the system institutions could book as an asset the land or other collateral at is current appraised value, thus reflecting in its accounts the difference between the original loan asset and the current "deflated" appraised value. This will nevertheless allow the system institutions to portray a truer financial picture to the capital markets, and a better one than is likely to be the case with forced sales of defaulted collateral.

We realize that others have proposed a central national warehousing authority to purchase the doubtful loan assets in the portfolios of system institutions. We doubt that such a national corporation is the answer, and we are certain that a statutory arrangement in which decisions about land and farmers are made locally is preferable.

The bill provides that the FFCIC may make special regulatory rules about leaseback assets and may charge higher premiums to reflect the risks inherent in these assets versus the risks inherent in performing-loan assets. The fact that higher premiums will be charged to system institutions for leaseback assets in the portfolio will itself be a form of discipline on the local decisions as to when and under what terms to take title and lease back farm land and other collateral.

We are under no illusion that these leaseback provisions will be a panacea. But if perhaps two-thirds of the land that would otherwise be forced on the market through the system's foreclosure and sale requirements could be kept off the market, and farmers kept on the land, a significant contribution would have been made. Furthermore, if it can be accomplished with local decisions, and be based on a realistic view of what the land can produce at current commodity prices, the provision is well wroth enacting as an additional tool for use by the Farm Credit System.

III. Comments on other Model for Change

There seems to be widespread consensus that, in the current agricultural crisis, legislative changes must be made to the Farm Credit Act of 1971.

From discussions around town, it seems perfectly clear that the Congress will be presented a spectrum of possible changes.

A. The Central Regulator Model

There will be the "central regulator model" in which you will be asked to throw additional power to the Farm Credit Administration without really making any other structural changes in the way things operate. It is our belief that simply throwing greater power to the Farm Credit Administration will not adequately reassure the capital markets. We can guarantee you that it will not reassure the farmer-rancher borrowers of the system.

B. The Central Entity Bank Holding Company Model

A second basic model is the "Central Entity Bank Holding Company" model. Under this one, the farm credit system would become more like a national bank holding company operating through subsidiaries in 50 states, that would be very lightly regulated, that would be able to merge and liquidate associations across the country at will, that would probably freely obtain Treasury money, and that would be less rather than more accountable to shareholders.

Even if this model were somewhat appealing to the capital markets, which we doubt, it will not restore the confidence of the shareholder-borrowers in the long-term viability of the farm credit system. This model moves away from local control in any meaningful sense of the term and leaves unsettled the political unrest that already permeates the system's borrowers throughout the country.

C. The "Open Spigot" of the Treasury

The third model is basically one that would simply let the existing system plug into the Treasury and get the full faith and credit of the United States to back the system's bonds. While we will comment on federal assistance packages in a moment, suffice it to say here that the shareholders on whose behalf this statement is made oppose opening the Treasury to the farm credit system until basic structural reform of the farm credit system has been enacted.

IV. Comment on Federal Assistance

The shareholder groups believe that the farm credit system continues to have sufficient assets to make a significant contribution toward meeting the system's obligations, if the assets are prudently managed and if Congress enacts the structural changes proposed by the shareholders.

We believe that federal money should not be provided to the farm credit system until the system has demonstrated that it is using its own assets to meet its obligations and until structural changes have been made by Congress to allow federal money to be prudently employed.

We note that our proposed FFCIC would be a prudent and effective instrument through which Treasury assistance could be provided most efficiently, by guaranteeing the FFCIC obligations, by loans to its insurance fund, or by grants through it, if federal assistance should ultimately prove necessary because of a worsening world agricultural situation or otherwise.

Conclusion

For the reasons given, we respectfully urge that the Congress give serious consideration to the essential reform elements contained in this shareholder proposal, recognizing that if this country is to continue to have a farmer-rancher owned farm credit system that has the confidence of the capital markets and of its intended farmer-rancher borrowers, shareholder control and accountability for the system must be strengthened.

Thank you.

JOINT STATEMENT OF ROBERT A. CARSON, COTTON & SOYBEAN FARMER, PCA BOARD CHAIRMAN, LAMBERT, MISSISSIPPI, AND JAMES HENRY GILFOIL III, COTTON & GRAIN FARMER, PCA BOARD MEMBER, LAKE PROVIDENCE, LOUISIANA, ON BEHALF OF FIRST SOUTH PRODUCTION CREDIT ASSOCIATION

IDENTIFICATION

1. We represent the 21-member board of directors of the recently formed First South Production Credit Association.
2. Our association is in the Fifth Farm Credit District, which covers Alabama, Mississippi and Louisiana. First South PCA was formed through the merger of 16 PCAs in the three-state area. The headquarters office is in Jackson, MS.
3. We appreciate having this opportunity to tell you about how and why our merger took place and about what conditions are like in our district today.
4. We have provided you with a small package of material describing the rationale of our recent merger and some of the positive results that have taken place since that time.

WHAT IS THE MAJOR PROBLEM IN AGRICULTURE TODAY?

5. The major problem in agriculture today is a LACK OF PROFITABILITY. Until profitability is restored to the American farmer, we will continue to suffer under extremely critical economic conditions.
6. The gap between total farm debt and net farm income has continued to grow wider over the past decade. Land values continue to drop because of the lack of profitability in farming. And because of rising debts and falling land values, the equity for the typical American farmer is now being squeezed out.
7. The vicious cycle of falling income levels and dwindling farmer equity has caused Farm Credit lenders, such as production credit associations, to be subjected to unusually stressful business and financial conditions.

WHAT ARE PCAs DOING ABOUT THE PROBLEM?

8. Nevertheless, PCAs have gone the extra mile with their member/borrowers. The result in our own district has been that PCAs have suffered loan losses amounting to over $60 million over the past three years. In so doing, our PCA has lost virtually all of its retained earnings and reserve for bad debts that had been generated over its 52 years of existence. We no longer have retained risk funds, and we are now dependent upon our equity in the FICB of Jackson to pull us through these stressful economic conditions in agriculture.

9. These losses have had a devastating effect on some PCAs. In our recent history, we had 26 associations. As PCAs started encountering difficulty, however, they started merging with their neighboring associations to gain more stability and financial strength in their operations.

10. Several months ago, a task force of PCA directors in our district was formed to find a solution. First we thought about merging by state. Then it became obvious that the only real solution was to merge into an association that would cross state lines and would include all three states.

11. When the district-wide merger first came up as a possible strategy for dealing with our problems, we didn't like the idea. It appeared at the time that a merger would mean giving up control by local farmers.

12. But soon it became obvious that this merger was the only reasonable approach for us to accomplish our two main objectives:

- First, we wanted to achieve much greater efficiency and effectiveness in our business by consolidating our capital and human resources.
- Second, we wanted to maintain local, grass-roots support and direction for our loan servicing operations.

13. Finally, this past summer the merger took place when 16 associations in our district voted to merge their capital and human resources into one large association that came to be know as First South PCA.

14. This was not an easy decision. It took courage. The directors who formulated the idea had to discuss the issues. We disagreed on many points. Sometimes our decisions meant giving up personal political and emotional desires. But in the end we were able to reconcile our ideas with what we knew would be in the best interests of farmers throughout our 3-state area. When the merger proposition was presented to the membership for consideration, 92 percent of those voting favored the merger.

15. Let me state emphatically at this point that the decision to merge was made strictly by directors and other farmer/members of the district PCAs. The function of management throughout this whole process was to furnish education, information, and leadership to the directors. At no time in the process was there a threat of management

interference. If there had been interference from management, the merger process would have failed. The merger of 16 Fifth District PCAs into one PCA represented the ultimate form of "grass roots control" which could be exercised at the district level to solve our own problems.

WHAT DID WE ACHIEVE?

16. Thus far, it appears we have exceeded our greatest expectations for our newly formed association. On the day the merger officially went into effect, interest rates dropped immediately to 10.7 percent. For some of the merging associations, this meant an instant drop in rates of over 2 percent. We have provided you with a list of the interest rates for all the merging associations. This list shows a comparison of rates both before and after the merger.

17. This drop in interest rates came about primarily for three reasons. First, there was a drop in our cost of funds from the FICB. Secondly, because we were able to consolidate the chief executive officer, we had a reduced need to continue increasing our cash reserves. And thirdly, there was a reduction in our operating budget as a result of greater efficiency within the newly formed PCA. This decline in operating expenses came about primarily through staff reductions in both the FICB and the PCA. (See Attachment or Accomplishments and Objectives.)

18. I remind you that our first objective in merging our PCAs was to achieve greater efficiency and effectiveness. At this time, we are well on our way to accomplishing this objective.

19. Now, remember that our second objective was to maintain grass roots support, direction and control. We have come to realize that since the merger took place, we now have far more control than we ever had before. Instead of directing the operations of our individual territories in each of our respective corners of the district, we now provide direction and control for the three-state PCA, and we have been able to maintain grass roots involvement. Other than a drop in interest rates, our membership has noticed very little difference in the operation.

20. We have also maintained local control by creating 26 operating regions, each having regional directors to provide advice and direction into the decisions that must be made at the local levels.

21. Therefore, we have gained the best of both worlds. We have become more efficient and effective by combining our capital and human resources. And we have maintained, and in certain respects, increased our local, grass roots input and control of PCA operations. To provide you with a comprehensive list of these achievements, we have attached a list of our Accomplishments and Objectives for First South PCA.

WHAT ARE CONDITIONS LIKE THROUGHOUT THE SYSTEM?

22. As you know, the Farm Credit System is undergoing considerable stress now. The 37 banks within the System are mutually obligated to stand behind our bonds sold on Wall Street. This combined strength has provided us with a dependable source of funds for the past several decades. And it has provided our farmer/members with traditionally competitive lending rates.

23. But in a sense, the 37 Banks have all signed each other's notes. Therefore, the FICB of Jackson is obligated and has provided assistance to other districts that are experiencing financial difficulty. This action has been necessary, and it is indicative of one of the strengths of the cooperative nature of our system.

24. Unfortunately, the Fifth District FICB/PCA has reached the point where we cannot come to the aid of other districts without seriously threatening the viability of our own organization. We have done everything within our control to maintain viability within our own operations without asking for outside help.

25. The FICB of Jackson has infused capital into troubled Farm Credit Districts. This action was weakened our liquidity position, and we cannot continue to deplete our capital. Such action would ultimately cause us to seek outside assistance.

SUPPORT OF PROPOSAL FOR FARM CREDIT SYSTEM SELF HELP AND FEDERAL ASSISTANCE

26. Therefore, we come to you today to join in support of the efforts of the Farm Credit Council to request government financial assistance for the Farm Credit System. Without such assistance, we are deeply concerned about the lack of stability throughout the System as a whole. And we are distressed about the likely impact this will have on farmers throughout our nation.

27. We feel we must state, however, there are certain actions we do not want the government to take:

    - First, we don't want the government to turn our system into simply another government agency. This alternative would bring about a never-ending burden for the American taxpayer, and it would erase local grass roots involvement.
    - Second, we don't want the government to block mergers within our System. We feel such mergers are a necessary and constructive means for local associations to take control over their own situations and regain stability within their operations. We believe this action has brought about greater efficiency, effectiveness, and grass roots control over our situation. We have provided you with a brochure entitled "Call for Action," which we feel describes in greater detail why it is necessary for association mergers to continue to take place.

28. We need assistance to help strengthen the system during this difficult period. But we do not want to be dependent on government assistance forever. We want to be able to maintain our viability and become capable of repaying this government financial help at the earliest opportunity.

29. When the PCAs were formed over 50 years ago, we began with seed capital from the government to help us survive those early, formative years. Eventually, we were able to pay back all of the seed capital and create a fully independent system of farmer-owned financial cooperatives.

30. Now we come to ask you to help our system survive this period of great financial stress. Once again we need government assistance. And as in the case of our early years as a system, we will eventually pay back every nickel of government financial help we receive.

31. Again we emphasize that the real problem is lack of profitability in American agriculture. And the only solution to that problem is to improve profitability.

32. We want to express our sincere appreciation to you for allowing us to tell our story -- that we as grass roots farmer/members of our PCA, when provided with the right information and opportunity, can and will make courageous decisions to solve our own problems and establish the course of our own destiny.

33. Thank you for giving us this opportunity. You and your colleagues are being called upon to make some very courageous decisions concerning the American farm economy. Your decisions will undoubtedly have a profound and lasting impact on nearly every farmer in this country. And we are confident that as you consider these proposals you will keep America's need for the production of food and fiber always at the forefront of your decisions.

FIRST SOUTH PCA INTEREST RATES

Association		Before Merger Int. Rate August, 1985	After Merger Int. Rate September 1, 1985	Decrease in Int. Rate Charged to Members
Coosa Valley		12.25	10.70	1.55
Demopolis		11.50	10.70	.80
Huntsville		11.50	10.70	.80
Montgomery		12.25	10.70	1.55
Russellville		12.95	10.70	2.25
South Alabama		11.65	10.70	.95
Southwest MS		12.25	10.70	1.55
First Delta		12.25	10.70	1.55
Hattiesburg		13.00	10.70	2.30
Central MS		12.50	10.70	1.80
Northeast MS		12.50	10.70	1.80
Oxford		12.00	10.70	1.30
Baton Rouge*	(1)	10.40	10.20	.20
	(2)	10.65	10.45	.20
	(3)	10.90	10.70	.20
	(4)	11.40	11.20	.20
Pelican		11.75	10.70	1.05
Opelousas		12.75	10.70	2.05
Tallulah		12.50	10.70	1.80

* Baton Rouge uses differential interest rates.

ACCOMPLISHMENTS & OBJECTIVES
FICB OF JACKSON & FIRST SOUTH PCA

1. Reduced FICB budget by $1 million, or 15% of the 1985 budget, approximately 25% of the controllable budget (uncontrollable budget now runs 30% of the total budget).
2. Reduced PCA 1986 operating budget expenses by $2.5 million or 15.3% from 1985 projected operating expenses.
3. Set up workout centers for liquidating loans.
4. Moving toward top, hands-on management, working in close coordination to serve the needs of the members -- 26 operating units -- 87 branch offices.
5. Salary administration and incentive plan to promote efficient and effective service resulting in position bottom-line results.
6. Directors will provide overall direction in policy, planning and controls (directors will direct).
7. CEO will work with both the FICB board and the PCA board on policy, controls and strategic planning (allows managers to manage).
8. Centralized capital and human resource.
9. Decentralized loan servicing and decision making.
10. Established competitive interest rates:
    - Effective September 1, the FICB spread will be 50 basis points which will convert to a loan and discount rate of 9.70%.
    - PCA spread will be 100 basis points which will equate to a 10.70 interest rate to members.
    - We will install differential interest rates.
    - We will install a matched funding (fixed rate) program.
11. Maintain grass roots input and counsel through regional directors.
12. FICB anticipates returning 100% of earnings in cash to the PCAs and ACCs.
13. FICB has a very strong capital and liquidity position to assist the troubled PCA.
14. CEO in dual capacity has direct control over both corporations, thereby assuring quality and control between the two corporations.
    - PCA retained risk funds are virtually wiped out and we must depend of FICB capital to pull PCA through these economic adversities.
15. Financial service centers will provide professional services such as the sale of computer hardware and software, training, farm records, PCA marketing training, etc. to members, PCAs, ACCs and other business customers.
16. The financial condition of the average farmer in the Fifth Farm Credit District is more depressed than anywhere in the nation. However, due to the strong leadership, courage to make difficult decisions, and deep commitment of the PCA board, we have been able to reorganize and survive and maintain our viability during the worst of circumstances.

- PCA directors (grass roots) provide strong leadership in the design of the reorganization and support of the merger of PCAs.
- Good control standards in place to assure sound and constructive credit administration practices.

17. Due to centralization of human resources, we have been able to place our top employees in the most effective and efficient area of responsibility to full utilize their respective expertise and talents.
18. With the merger in place, we are now in a position to streamline our operations to be commensurate with loan volume and bottom line performance.

CALL FOR ACTION
ISSUES SURROUNDING THE FIFTH FARM CREDIT DISTRICT'S STRATEGY FOR DEALING WITH THE AGRICULTURAL ECONOMIC CRISIS

(Prepared by the Federal Intermediate Credit Bank
of Jackson, Jackson, Mississippi)

Today's date - September 1, 1985 - marks the start of a new era in agricultural finance in the Fifth Farm Credit District, consisting of Alabama, Mississippi, and Louisiana. For today is the first official day of operations of First south Production Credit Association - a new concept in the deliver of farm credit and other financial services to American farmers. First South PCA has been formed through the merger of 16 PCAs in our three-state area. This merger has received a vote of approval from 92 percent of the members voting, and has involved the consolidation of capital and human resources of the merging associations. The result has been a new PCA that will be geared to serving the farmer more efficiently and more effectively than ever before.

The unique quality of First South PCA is that it will be reducing its operating costs by consolidating all administrative functions. At the same time, it has improved the effectiveness and quality of service to its members by dispersing the lending authority to its regional and branch offices. This the association will be more capable than ever of delivering the quality service farmers deserve at prices they can afford. But farmers continue to struggle today under extremely stressful economic conditions. Their main problem is a lack of profitability brought about by falling commodity prices and rising operating costs. Until profitability is restored to American farmers, we will continue to see erosion of their equity and an increased number of foreclosures and bankruptcies.

The pages that follow contain responses to some very though and hard-hitting questions about American agriculture. There are no easy answers to the farm problem in our country today. If there were, someone would have solved agriculture's problems long ago. But hopefully the discussion that follows may shed light on some of the changes that have been taking place in the

Production Credit Associations of the Fifth Farm Credit District. We must all dedicate ourselves to helping find ways to restore profitability to American agriculture, for that is the only way to solve the plight of our nation's farmers.

Jack D. Condra,
Chief Executive Officer.

1. **How severe is the ag economic crisis in America today?**
    - Major problem - LACK OF PROFITABILITY
    - Gap between total debt and net income growing wider
    - Land values continue to drop
    - Farmer's equity squeezed out

The major problem facing farmers today is a LACK OF PROFITABILITY. The unprecedented inflation of the late seventies caused farm operating expenses to rise dramatically. Unfortunately, commodity prices did not keep pace with these rising operating costs, thus making farming very unprofitable. And because farming has been so unprofitable, farmland values have been tumbling. Furthermore, the gap between the typical farm debt load and the net income produced by that farm has widened tremendously. This, the equity a typical farmer owns in his business has been squeezed out by falling land prices and rising debts. And this loss of equity and local of profitability have made it impossible for many farmers to service their ever-growing debt loads.

2. **What steps are PCAs taking to deal with this crisis?**
    - Going extra mile with needy borrowers
    - Restructuring organizations
    - More efficient business operations
    - Continued Competitive rates

Because each PCA is owned by its borrowers, it has been especially willing to go the send, third, and fourth mile with those borrowers experiencing special difficulties. Loan extensions, renewals, and voluntary liquidations have been common examples of such efforts. Furthermore, it is mutually beneficial to both farmers and their lenders that the farming community remain financially healthy. Therefore, PCAs have been working closely with borrowers to help them resolve their financial difficulties.

In a recent move to address the agricultural economic problems confronting the farmers of Alabama, Mississippi, and Louisiana, the directors of Fifth District PCAs took bold and decisive action in proposing a merger of their respective associations. This merger, which was approved by 92 percent of the members voting, will make these PCAs more efficient and will help to keep down the costs associated with administering and servicing the loans of their borrowers. In fact, the cost savings associated with the merger of these associations has enabled them to continue offering competitive rates to their member/borrowers. The new association formed by this merger officially became effective on September 1, 1985 under the name of First South PCA.

3. **Are lenders having financial difficulties also?**
   - Farmers and lenders have paid dearly
   - Total Fifth District PCA loan losses in 1983 and 1984 alone more than doubled total loan losses for previous 50 years
   - More losses anticipated in 1985

In going the extra mile with borrowers, PCAs have experienced severe losses due to the stressful economic conditions their members are experiencing. Until 1983, the total amount of loan losses Fifth District PCAs had incurred since their formation in 1933 was $21 million. In 1983 alone, PCAs lost over $24.5 million. Losses for 1984 were about $23.6 million. And heavy loan losses are projected again for this year. Other agricultural lenders, including commercial banks, have suffered similar levels of loan losses. There should be no question that both PCAs and commercial lenders have "gone the extra mile" in working with their borrowers to fulfill their financial obligations.

4. **Why should farmer/members be concerned about their PCA taking loan losses? Don't PCAs need to stay with borrowers longer in order to ease farmers' financial burdens?**
   - Dual responsibility
   - Needs of individual member vs. needs of total membership
   - Loan losses are paid for by the members through higher interest rates

Farm Credit institutions have a dual responsibility. On the one hand, they must be sensitive to the financial needs and conditions of individual borrowers. On the other hand, they must consider the welfare of the association membership as a whole. Consequently, when a PCA stays with a borrower too long and suffers a loan loss as a result, the remaining members of the association bear the burden of this loss. And they bear this burden in the form of higher interest rates.

As an illustration, consider what happens if a PCA with a $30 million loan volume loses $1 million. Typically, an association this size would have about $4 million of its own fund invested in the loan portfolio and would be borrowing about $26 million from the Federal Intermediate Credit Bank to finance the balance of its lending operation. If $1 million of the $30 million is written off the books as losses, the PCA will now have $29 million, from which it can continue to generate income that will pay its operating expenses and build capital for future growth. This means that, because of the $1 million loss, those farmers who have the $29 million in loans will have to pay almost one-half of one percent more in interest rates in order to maintain the same level of income to pay expenses and build capital.

It is for this reason that PCAs must balance their responsibility to the individual farmer with their responsibility to the entire membership of the association when considering individual loans and when assessing the risk involved.

5. **Who controls the operations of each production credit association, including the newly formed First South PCA?**
   - Membership elects PCA Board members and Regional Directors

- PCA board provides overall policy direction and control.
- Board delegates operational authority to CEO

The PCA board members are elected by the membership of their association. They are responsible to the membership for providing positive direction and leadership and for protecting the assets of the association. The PCA board provides overall policy direction and control of the PCA in carrying out the mission of the association. The PCA CEO, in turn, controls the day-to-day operations of First South PCA and implements the policies and directives of the association. Through his leadership and direction, the PCA carries out its various functional responsibilities of providing credit and related services to its member/borrowers. Also, regional directors provide local advice and counsel to regional management in carrying out the business of the PCA.

6. **How do PCAs obtain the funds to lend to farmers?**
   - Funds obtained through sale of Farm Credit bonds
   - Backed by collective obligation of all Farm Credit institutions
   - Reliable source of funds
   - Produces competitive rates for borrowers

PCA obtain funds primarily by borrowing from Federal Intermediate Credit Banks. In so doing, they also purchase stock in the FICBs, and thereby become the primary stockholders in each bank. The FICBs, in turn, join the other banks of the Farm Credit System in selling Federal Farm Credit Consolidated Systemwide Bonds. These bonds become the collective and individual obligation of the 37 Farm Credit Banks and, therefore, are backed by the combined strengths of the Federal Land Banks, the Federal Intermediate Credit Banks, and the Banks for Cooperatives. This combined strength and long record of stability of the various institutions of the Farm Credit System has allowed our bonds to carry very favorable interest rates in relation to market conditions. These more favorable rates have, in turn, been passed along to the PCAs and farmer/members in the form of traditionally competitive lending rates.

7. **Why are various associations trying to merge their organziations?**
   - Mergers are a means to maintain a viable business.
   - Strengthens assets of merging associations
   - Adds stability to association
   - Provides greater protection for stockholder equity
   - Occurs only through authorization of the member/borrowers
   - Effective form of "self-help"

The recent moves to merge associations in various districts have not come about as a means for management to reduce member/borrower control of the business. Rather, they have come about as a means for PCA boards and management to maintain a viable business. The various institutions of the Farm Credit System are now undergoing tremendous financial stress. In some cases, associations have run into considerable financial difficulty and have had trouble remaining in business. In the Fifth Farm Credit District a task force of PCA directors was formed to search for an appropriate strategy for addressing this problem. The strategy selected was to seek a merger of district associations that would preserve a competitive position, ensure continued viability in the district, and enhance quality of service and cost efficiency in providing sound and constructive credit and related services to members.

This has been an effective strategy for strengthening the assets of the constituent associations. It has been a means of bringing considerable stability to the operations of the merged organizations. And it has thereby served to provide greater protection for the equity of its member/borrowers. Furthermore, this merger has come abut only through the collective authorization of the member/borrowers. As such, it has been an effective form of "self-help" - a means by which a group of Farm Credit organizations have attempted to solve their own problems without outside assistance.

8. **Why do associations come to the aid of other associations that are having problems?**
   - o Part of cooperative system
   - o Each PCA shares in the Systemwide obligation to bond holders
   - o Failure of one increases relative liability of all others
   - o In best financial interest of each to assist each other

The associations of the Farm Credit System are all cooperatives; they are owned by the farmers who borrow money from them. Furthermore, the stability of the system as a whole is dependent on the stability of the various institutions that make up the system. Therefore, the financial stability of any one association is very much a concern to the other associations within its district and throughout the rest of the system.

As previously stated, the member/borrowers who own the various associations of the Farm Credit System have enjoyed comparatively modest interest rates as a result of the their combined strength. No individual association could enjoy such a sustained access to competitively priced funds without the combined strength of all of the other associations. But with this privilege comes certain obligations. In particular, each association (through partial ownership in its respective Farm Credit Bank) is obligated to stand behind the worth of the various systemwide securities that are issued to investors (the System's source of funds for loans). Therefore, the failure of one association increases the relative liability of each other association.

Thus, it is because of the system's cooperative structure that all associations are obligated to assist association that are experiencing financial difficulty. And it is in the best financial interests of each association to honor these obligations.

9. **What advantages are realized, then, by merging the association? Can't you save the system simply by helping the weaker organizations when they need help, and not actually merging the resources of various association?**
   - o If losses are shared, this tends to weaken other PCAs

- As new PCAs need help, stability of system as a whole is shaken
- Bank assistance results in increased cost to members
- No magic pot of money
- Larger capital base produced through merger provides greater protection against loan losses
- Helps to streamline PCA operations and reduce expenses

It is true that the associations in any one district may come to the aid of a failing association by sharing in the costs resulting from loan losses. It is also true that the Farm Credit Bank for that district may infuse capital into the failing association to bolster its financial structure. Various problems, however, result from such strategies.

First, all of the PCAs participating in the exercise of a loss sharing agreement become somewhat weakened by this participation. Such a move tends to particularly affect financially weak associations, making them move vulnerable to adversity. Then, if these associations require assistance, the loss sharing agreement may be exercised again, causing still more financial damage to the participating PCAs.

In the case of a Farm Credit Bank infusing capital into a failing PCA, the other district associations will not immediately be weakened as they would be under the earlier scenario. Nevertheless, the bank would be forced to increase its interest rates to the associations. This action would be required to make up for lose revenues no longer realized by the bank from the capital infused into the PCA. Such revenues are used to cover operating expenses, to sustain a reserve for bad debt, and to establish a financial reserve for the bank.

Therefore, there is no magic pot from which anyone can draw money in order to recoup loan losses. Such losses must be paid for ultimately by the members themselves.

Merging the capital and human resources of associations helps to overcome such problems. The larger capital base of the merged association provides greater protection for the association in the event of loan losses. Any by concentrating many of the administrative functions into one location, the PCA is able to streamline its operations, reduce its expenses, and focus its attention on making the servicing loans at the local level.

10. **But don't the member/borrowers lose control within their association one a merger takes place?**

- Very little change for the member
- Move to localized lending authority
- Regional and PCA board director representation

The member/borrowers actually experience very little change in operations after a merger takes place. In the case of Fifth District PCA mergers, lending authority will be localized. That is, the making and servicing of loans will be focused increasingly at the local branch office level. The result will be direct service to the member/borrower.

Furthermore, members retain control of their association through their elected regional and PCA board directors.

11. **What advantages do members have by merging their associations?**

- Allows retention of dependable and competitive source of funds
- Provides funds at relatively favorable rates
- Provides greater protection of member stock
- Allows potential for expanded member services

The primary advantage members have in merging their associations is they will be better able to retain a dependable source of funds at competitive rates. Without merger, many associations would cease to exist, and the stability of the district and the system as whole could be endangered.

A second advantage is that the stability of a large, merged association provides greater protection of member stock in the association.

Thirdly, a larger association has the potential to provide expanded member services.

In summary, the merger associations in the Fifth District offers a viable course for PCAs to follow. It is a course by which PCA directors and members are showing considerable courage and initiative by taking control of their situation and developing solutions that produce the greatest level of service to the member/borrowers.

STATEMENT OF STEVE H. HANKE, PROFESSOR OF APPLIED ECONOMICS THE JOHNS HOPKINS UNIVERSITY, BALTIMORE, MD

Mr. Chairman, allow me to express my appreciation to you and your colleagues for the opportunity to present my views about the problems facing the Federal Farm Credit System and their solution. For purposes of my written testimony, I would like to submit a paper, "Rx for the Farm Credit System", that I recently wrote for the Ludwig von Mises Institute and request that it be included in the record. This paper contains a detailed presentation of the analysis that I will now summarize for your and your colleagues.

Rx for The Federal Farm Credit System

(By Steve H. Hanke)

The Federal Farm Credit System

The Federal Farm Credit System (FCS) is a loosely connected organization of quasi-banks that was established by Congress between 1916 and 1933. Presently, it contains 37 member banks, each one cooperatively owned by member-borrowers. There are 12 Federal Land Banks, which make mortgage loans to farmers through 431 local Land Bank Associations; 12 Federal Intermediate Credit Banks, which advance funds to about 370 local Production Credit Associations, which in turn make short-term farm-operating loans; and 12 Banks for Cooperatives, which lend funds to farmer-owned service and supply cooperatives. The 37th bank in the system is the Central Bank for Cooperatives.

The FCS is regulated by an independent Federal agency, the Farm Credit Administration (FCA). However, FCA's regulation is more nominal than real. Even though the FCA examines the books and credit practices of the FCS banks and association, the FCA has no authority to move against unsound practices. For example, the FCA can't issue cease and desist orders; it can only recommend changes.

Federal legislation has made each member bank virtually autonomous. In consequence, each operates with its own set of accounting and credit practices. However, in times of stress, member banks are obligated to assist each other under loss-sharing and capital preservation agreements.

The FCS banks don't accept deposits. Most of their funds are obtained through the sale of bonds by the Federal Farm Credit Banks Funding Corporation, which is located in New York City. Debt issued by the Funding Corporation, although not guaranteed by the Federal government, has traditionally been viewed by investors as carrying little risk. For example, FSC bonds have typically carried spreads of between two and 10 basic points above comparable U.S. Treasury bill rates. However, spreads have recently widened to between 90 and 120 basic points over comparable Treasury bills.

The FCS' Alleged Financial Status and Bailout Options

The FCS is the nation's largest farm lender, with about $74 billion in outstanding loans. Of these, $9.8 billion are listed as nonperforming, and of these, about $2 billion aren't accruing interest. (1) In addition to facing problems with its balance sheet, the FCS is realizing operating losses. For example, its third-quarter losses ballooned to $522.5 million. (2) These financial data certainly don't bode well for the FCS. In fact, they have given rise to claims that, to survive, the FCS will need a massive Federal bailout within the next two years. (3)

The proposed methods for accomplishing a Federal bailout include:

- a direct infusion of capital into FCS by the Federal government
- Federal government guarantees for FCS loans
- a line of back-up credit from the U.S. Treasury to the FCS
- A federally-financed "warehouse" to purchase assets (bad loans) from the FCS
- a federal program to "buy-down" borrowers' interest rates on FSC loans (4)

Although each of these proposal differs, both in terms of its magnitude and the means for delivering a bailout, they all would commit significant amounts (perhaps as much as $10 billion) of federal taxpayers' money to pumping credit into agriculture.

A Cautious Reaction to Bailout Proposals

Even though the FCS appears to be in some trouble, neither the Congress nor the Reagan Administration has jumped on the bailout bandwagon. One reason for their caution is the fact that the FCS' financial data are soft. That is to say, the FCS' books are unaudited. In fact, they have never been subjected to an independent audit. (5) In consequence, it is difficult to know just how much trouble, if any, the system is facing. This will not be known until later this year, when Price Waterhouse completes the FCS's first outside audit.

Several other factors have also made many policy makers reluctant to embrace a federal bailout. For one, some FCS loans that are classified as nonperforming by the FCS would be classified as performing by commercial banks. In addition, the potential losses from defaults on nonperforming loans would be significantly less than the full face value of the bad loans because almost 75 percent of the FCS's loans are secured by real estate. (6) If this were not enough, the FCS is well capitalized, when compared to most commercial banks. It has $4.2 billion of retained earnings. $675 in loan loss reserves and $5 billion of capital paid in by member-borrowers. (7) This cushion would be enough to allow the FCS to sustain larger losses than are now foreseen and still survive.

FCS's Alleged Problems Offer An Opportunity for Innovative Reform

We agree with those who have failed to accept the requests for a FCS bailout.

The following premises constitute the foundation on which we base our position:

- o Aid to businesses (farmers) in deep financial trouble doesn't constitute a proper role for the Federal government a proper use of federal taxpayer's money.
- o In any case, most farmers are not on the verge of business failure. (8)
- o Hence, the agricultural financial system is not about to collapse and pull the entire U.S. financial system down with it. (9)
- o A bailout would only rekindle "overpricing" of farm assets, which is the chief cause of the current stress.
- o Any proposed "solution" that ignores the need for a significant reduction in the amount of borrowed capital employed by American agriculture is doomed to fail.

Even though we conclude that a FCS bailout is unwarranted, we do counsel that the current agricultural credit situation offers an opportunity to strengthen the FCS--which all would agree is facing some qualitative stress--and at the same time, strengthen the agricultural sector of the economy. To reach these objectives, we develop a proposal that requires the federal government to put its own credit house in order.

The Linkage Between Collateral Land Values and Agricultural Credit

U.S. agriculture has seldom produced a cash return on investment that has matched other industries. Success or failure in farming, measured in terms of rate of return on investment, has been largely dependent on changing land values. The importance of land values becomes even larger in the agriculture sector, when we realize that about 60 percent of all the agricultural loans in the U.S. are secured by real estate. (10) It is not surprising, therefore, that agricultural lending is heavily influenced by the evaluation of agriculture's most important asset, land. Unlike most other forms of commercial lending, credit evaluation in agricultural lending is primarily predicated on the assessment of asset values (land), rather than on the evaluation of cash flows. In consequence, agricultural lending institutions must reply on credit evaluations that are less sensitive to changing economic conditions than institutions that lend money for nonagricultural purposes.

The Market For Extending Agricultural Credit

The market for agricultural credit is dominated by large institutions (see: Table 1). However, individual seller financing is important, particularly for the purchase of land. Among the institutional sources of borrowed capital, a board continuum of approaches exists, ranging from direct government loans offered by the Farmers Home Administration (FmHA) and the Commodity Credit Corporation (CCC) to private loans made by commercial banks and individuals.

Perhaps the most interesting feature of the agricultural credit market is the fact that, since 1970, it has evolved away from private sector credit sources toward the public sector, This is particularly the case if we consider that the FCS, although not public, has traditionally been viewed by investors as possessing some degree of implicit public support (see: Table 1).

Table 1
Market Shares in Agricultural Lending
(Percent)

	1970	1984
Commercial Banks	27.3	23.6
Farm Credit System (FCS)	23.2	31.8
Farmers Home Administration (FmHA)	5.7	11.5
Life Insurance Companies	10.1	5.8
Commodity Credit Corporation (CCC)	3.7	4.5
Individuals & Others	29.8	22.8

Source: U.S.D.A Economic Research Service,
Agricultural Information Bulletin, No. 490, March 1985.

Some Features of the FCS and The Agricultural Credit Market

The FCS is the single largest institutional source of borrowed capital for the agricultural sector of the economy. Its extensive lending program is designed for the exclusive use of agricultural producers and cooperatives. The FCS' commitment to agriculture has necessitated a record of conservative financial management. For example, the sum of FCS' earned surpluses plus contributed capital is twice as large, relative to its asset base, as the comparable figure for the nation's 10 largest money center banks. In addition, the FCS has built an extensive and effective credit delivery system in rural America.

Diversified commercial lenders can identify bad loans more rapidly than the FCS and other institutions that lend exclusively to farmers. This, as we have mentioned, is a result of the fact that agricultural credit evaluation focuses, by necessity, on the valuation of land used as loan collateral, rather than on cash flows. Once commercial lenders identify bad loans, they charge them off quickly and increase their loan loss reserves. In consequence, their earnings, and in some cases their capital positions, deteriorate. But, the commercial lenders are free then to place new loans. This rather speedy adjustment process allows commercial lenders to continually cleanse their loan portfolios by substituting good loans for bad ones.

In the case of the FCS, several factors impede the self-correcting replacement of bad with good assets. First, with relatively infrequent scheduled loan payments and a reliance on collateral values for credit evaluation, bad FCS loans aren't quickly identified. Second, even after bad loans are identified, their liquidation is hampered because, in a weak market for farmland, wholesale liquidation will put downward pressure on neighboring land values. Hence, it will reduce the value of collateral used to back other FCS loans. (11) In consequence, the FCS is forced to withhold assets from the market, after they have been acquired through foreclosure, and the resulting portfolio of property acquired by the FCS represents and operating expense long after bad loans have been written down. The third factors that makes it difficult for the FCS to cleanse its portfolio by replacing bad loans with food ones centers on the fact that the FCS is exclusively committed to agricultural loans. As a result, in a weak market for agricultural credit, there are simply fewer opportunities for the FCS to find attractive loan opportunities. This is not the case for diversified commercial lenders who cleanse their portfolios, in part, by moving from weak to strong credit markets. (12)

RX for the FCS

We offer a proposal that will allow the FCS to improve the quality of its portfolio and strengthen its operations. The key element in our proposal is the Farmers Home ADministration (FmHA), an agency of the U.S. Department of Agriculture. The FmHA makes direct loans to eligible borrowers who are unable to obtain suitable credit elsewhere. The agricultural credit portion of FmHA's loan portfolio has grown rapidly, both in absolute terms and also in terms of its share to total agricultural credit. At present, the FmHA holds about $25 billion in outstanding agricultural loans.

The total volume of U.S. agricultural loans is declining, and must continue to decline. If America's agricultural sector is to become stronger and more competitive in world markets. Facing a secular decline in the agricultural credit market, it makes little sense to support two credit delivery system (FmHA and FCS) that are either directly or nominally under public sponsorship. Hence, we recommend that the agricultural credit portion of the FmHA be eliminated. Under this proposal, no new agricultural loans would be made by the FmHA. In a word, this would accommodate a shrinking market for agricultural credit by eliminating a massive public credit program.

The second element of our proposal concerns the existing $25 billion in outstanding FmHA loans. These loans would remain in place and would continue to be owned by the federal government. However, the servicing of these loans would be turned over to the FCS. In return for servicing these loans, the FCS would receive a servicing fee.

With the right to service the $25 billion portfolio, and an annual servicing fee of 2.5 percent, FCS' gross servicing revenue from the FmHA portfolio would equal $625 million. Given the FCS's extensive and underutilized credit delivery system, the FCS' annual incremental costs associated with servicing the existing FmHA portfolio would only be about $125 million. This means that the FCS would generate an annual net profit of $500 million from servicing the FHA loans. (13) At a 10 percent interest rate, these servicing profits would be equivalent to a temporary capital infusion of $5 billion into the FCS. (14)

This proposal would strengthen the FCS and reduce the political demands for a federal bailout. Moreover, it would accommodate a reduction in the total amount of farm lending by reducing the federal government's share of the agricultural credit market. By allowing for this type of orderly transition to less agricultural credit, the agricultural sector of the economy will become stronger and more able to compete both in home and international markets.

Notes

1. Aloysius Ehrbar, "Facts Vs. The Furor Over Farm Policy, "*Fortune*, November 11, 1985, pp. 114-120.
2. Charles F. McCoy, "Farm Credit System Reports 3rd - Period Loss", *The Wall Street Journal*, October 24, 1985.
3. Peter T. Kilborn, "Farm Bank Plea Gets Cool Reply", *The New York Times*, September 7, 1985.
4. Charles F. McCoy, :Out of Options: Farm Credit System, Buried in Bad Loans, Seeks Big U.S. Bailout", *The Wall Street Journal*, September 4, 1985; and William Robbins, "Farm Credit System Plans Big Aid Request", *The New York Times*, October 1, 1985.
5. Charles F. McCoy and Jeff Bailey. "Blighted Ledgers: Farm Credit System Relies on Accounting that Hides Bad Loans", *The Wall Street Journal*, October 7, 1985.
6. U.S. Department of Agriculture, *Financial Characteristics of U.S. Farms*, January 1985.
7. Ehrbar, op. cit. p. 118.
8. Luther Tweeten, "Farm Financial Stress, Structure of Agriculture, and Public Policy", in Bruce L. Gardner (ed.), *U.S. Agricultural Policy: The 1985 Farm Legislation*, Washington: The American Enterprise Institute for Public Policy Research, 1985, pp. 83-112.
9. Michael T. Belongia and R. Alton Gilbert, "Farm-Bank Fallout? Recall the '20s", *The Wall Street Journal*, September 25, 1985.
10. U.S. Department of Agriculture, op. cit.
11. From a technical point of view, there is a high covariance among the values of the various assets held as collateral

for FCS loans. This makes liquidation of collateral difficult because it tends, when land markets are weak, to lower the value of collateral used to back other FCS loans.

12. This practice is revealed by the data in Table 1. Note how the commercial banks have reduced their market share of the agricultural credit market as this market has weakened.
13. This serving revenue would decline as the loans are either paid-off or foreclosed.
14. The "capital infusion" would be temporary because it would gradually decline and terminate, when the FmHA loans were either paid-off or foreclosed.

STATEMENT OF WAYNE JOHNSON, MEMBER, VALENTINE PRODUCTION CREDIT ASSOCIATION, AINSWORTH, NE

I'm Wayne Johnson, farmer/feeder from Ainsworth, in north central Nebraska. I would like to present to this committee the stockholder's viewpoint of the present credit crisis of the Farm Credit Bank of Omaha District.

I have been a director of the local FLBA for eleven years and am currently chairman of the Board of the North Platte Association. Also served three years on the Director Advisory committee of the Omaha FLBA. Have been a borrower and member of Valentine PCA for twenty years, so feel I have first hand knowledge of how many of these problems were created.

The officials in the Farm Credit system would have you believe that the main problems in agriculture and agriculture credit are the result of low commodity prices. This is simply not true. commodity prices are not much different than they have been for the past several years.

The Farm Credit Banks have completely failed to fulfill the mandate set down by Congress to provide quality credit to agriculture. In the Omaha District credibility in the system has sunk to absolute zero for several reasons. Putting two PCA's into liquidation and freezing the stock sent out shock waves that are still being felt. Over one third of all PCA borrowers have left the system in less than one year in the four state area. Most that are left are loans that could not find credit elsewhere. To counteract this, the Omaha Bank put on a huge advertising campaign on TV and some farm magazines. This was intended to correct the negative image and promote the bank as strong and viable. But this only increased the borrowers panic, as the ads extolled the viability and strength of the system, when everyone knew that exact opposite was true. This image, or credibility problem, then began to spill over into the Land Bank side of the system and was helped along by a raise in interest rates, when the borrower couldn't even pay their present rate.

Land Bank borrowers are leaving in record numbers which increases the pressure on those who remain.

The lack of stockholder confident is not confined to the Omaha Bank alone. This is in evidence when the head man of the FCA in Washington repeatedly extolls the strength of the system and say no help is needed from government sources. He then gets up the next morning and start hollering that help is badly needed.

This kind of conduct makes you wonder where he has been or what he was doing. The problem did not occur over night.

What do we have to do to return the Farm Credit system to its former position as a strong and viable institution?

Make it willing and able to fulfill the role it was designed for - to provide quality credit to American agriculture at the least cost.

Since the seizing of the PCA stock, and holding these borrowers hostage is the root of the problem, this action must be reversed. Until this comes about by Congressional intervention, or by whatever means is necessary, only then will you return the borrower's confidence. Bail out money, in whatever amount, is not the solution. You must have the borrower or you don't need the bank.

Following are nine points that would help to correct the present situation:

1. A full disclosure of the farm credit financial situation - including non-performing loans - and the public disclosure of available reserves.
2. Reaffirm and emphasize the original intent and purpose of the Farm Credit Act to supply money ag borrowers at a reasonable rate.
3. Authorize the Federal Farm Credit System to assist in the issuance of government guaranteed bonds (possibly tax exempt for outstanding loans) for the purpose of an interest buy down.
4. Authorize government guarantee of the newly issued bonds to re-establish credibility.
5. Provide more active stockholder membership input into the situation.
6. Approve the principal of the Hawkins Farm Credit System Improvement ACt.
7. Recognize and come to grips with the losses already existing in ag finance.
8. Reiterate our position that all acquired properties be returned to the private sector in an orderly manner.
9. Request Congress to take a more active role to reduce the federal deficit.

The following is from an attorney who is familiar with the situation in this area, which I would like to include in my testimony.

Re: Production Credit Association in Valentine & O'Neill.

At the request of friends and clients who are former Valentine PCA borrowers, I am writing to request that their situations be taken into consideration and that they not be forgotten nor overlooked in future legislation regarding the Farm Credit System.

In general, I have spent considerable day sin the past year assisting Valentine PCA borrowers in negotiating settlements, attending meetings of their members and generally sharing their problems. My involvement has led me to make several observations and raised a number of questions which I find disturbing. I would appreciate you giving these matters some consideration.

1. The "B" stock issue is most troublesome. In order to deal with PCA at all, my clients were coerced into relinquishing their interest in their "B" stock by assigning it to PCA. We were repeatedly reminded that it had no value. If it is without value, why the pressure to sign it back?

2. Although my clients, and I on their behalf, repeatedly requested to see their files, there is not one instance where they were allowed to do so. How can their own loan files be withheld? (I will note that one client is now in District Court where we are seeking an order to examine the file. Thus far, PCA's attorney has not cited any law that prevents a borrower from seeing his own file, but we do not have a ruling on the request to produce the file.)

3. In one instance, my clients were invited to a PCA sponsored meeting with a commodity broker and encourage to hedge in the market. My clients knew nothing about commodity markets nor hedging but were loaned $50,000 by the Valentine PCA to hedge and then told PCA would meet the margin call, but there could be no more loan. In essence, the loan officers increased the debt by $50,000 in less than a day. My clients would have done as well if they had been given the money and sent to Atlantic City. I find it hard to believe this kind of lending policy can be pursuant to the law governing PCA's or the Farm Credit System.

4. People were induced to buy "B" stock as borrowers right up to the closing of the PCA. If the stock was worthless at that point, how can PCA now claim it had value. Also, there has never been any evidence of any records of "B" stock existence, although we have requested them. We have been told that there are no stock certificates, however, and that the records are all internal not subject to review by the borrower.

5. PCA personnel are quick to state that they were governed by rules and regulations adopted pursuant to the Federal legislation. To my knowledge, no such rules and regulations have ever been physically produced. Do they exist? We have been refused access if PCA has them.

In any event, these people in the Valentine, O'Neill and also Spokane, Washington area, need help. In my opinion, the "B" stock should be returned by legislative edict regardless of the settlement agreement. I would also ask that safeguards be built into legislation to insure that legislated funds reach the real members of the PCA's, i.e. the borrowers. If the farmer and rancher cease business in Nebraska, so do the business people of the rural areas.

STATEMENT OF RONALD E. VOTH, VICE PRESIDENT OKLAHOMA WHEAT GROWERS' ASSOCIATION

My name is Ronald Voth. I am a 39 year old farmer from Fairview, Oklahoma, and I operate a wheat and cattle farm. Currently, I am vice-president of Oklahoma Wheat Growers' Association and a board director of the National Association of Wheat Growers.

Let me tell you how the current economic conditions are affecting my personal business. We are a family-farming operation that uses large amounts of borrowed capital. We have been meeting our cash flow requirements with little left over. Basically this has been accomplished by my wife teaching school, excellent crop yields, and stocker cattle being somewhat profitable.

Continued high interest, record low wheat prices, erratic cattle prices, and continued high costs of production are just a part of our declining agriculture economy.

Like an avalanche gathering momentum as it thunders downhill, the present farm financial crisis continues to generate shock waves of mounting concern.

Many reasons exist for the impending crunch in agricultural credit. Namely some of them are high real interest rates, low commodity prices, deflation of assets, worldwide recession, faulty management by both the lender and farm borrower, and mismanaged government farm programs.

I could also relate statistics that point how bleak the picture is. But let this suffice - today my tractor is planting the wheat of a neighbor who lost everything in foreclosures and bankruptcy. This tells the story. These situations are common and real in my community.

Our land prices have declined 50% since 1980. Many farmers who have bought land in the last five years have little equity remaining. Neither is the end in sight. Rising bank-loan losses lead to tighter credit; consequently, there are more farm foreclosures, resulting in more bad loans and bank losses. The ball keeps rolling! Some feel the shakeout or unwinding in agriculture at one time was manageable, but not manageable at the present intensity. Eroding land prices must be leveled out and be stopped.

Economists say, "we have too many farmers" or "some farmers deserve to go broke because they bought land in the 70's in hopes of getting rich." These economists have forgotten that in the 70's farmers were educated that when inflation rates exceed interest rates, credit purchases of land were the prudent thing to do. Farmers didn't regulate inflation then, and they still don't today.

How is all this crisis affecting rural America? October 28, 1985, Deere and Co. laid off 480 employees. This latest round of layoffs will reduce the total Deere workforce in Waterloo to 7,100 employees, down from 16,160 in the fall of 1979. New farm equipment sales have literally haulted with the avalanche of used equipment available to buyers in need.

When profit is not in agriculture, farmers don't buy pickups, cars, clothes, equipment, buildings, etc. In the last six months, nine businesses have closed in two blocks of downtown main street of my hometown, Fairview, Oklahoma. All of this is the result of low commodity prices. It appears the jury is out to decide if we need rural America and the family farms, which are the roots of our great country. What will the verdict be?

Farm debt today is 220 billion dollars. Net farm income of an estimated $22 billion won't pay the interest on the debt. With inflation at 3%, interest on land at 12.5%, and land values declining 20% per year, my real interest rate is approximately 29.5% to carry debt.

Next June 1, my operating loan at my PCA is up for renewal. Will they renew or not? I live with that question when my equity is falling monthly. What is done by Congress to stop the decline in land values will probable determine if I am renewed by my creditor and if I am farming another year.

Are the inefficient the only farmers going belly-up? The Agriculture Department figures show 37% of all farms with sales of $250,000 or more are in financial stress. Will this spill over into the financial market? It has already. Over 100 banks are expected to fail in 1985 and possible 200 by 1986. Approximately 40% of these banks are agricultural banks. Five rural banks have been declared insolvent in the northwest area of Oklahoma this year. Both of my local bands survived the depression of 1930, yet both have recently been bought out to meet the additional capital requirements created by the large number of classified loans.

In 1950, there was $1.00 profit in agriculture for each $1.00 of agriculture debt. Today for each $1.00 of agriculture debt, there is less than $.08 profit. Agriculture produces 20% of the GNP. Ironically, the cost of the federal government consumes about 20% of the GNP; therefore, income produced by agriculture is sufficient to pay all the cost of federal government. My point is this: Depressed agriculture is already slowing down the growth of our nation's economy.

What will solve this crisis? First, return the profits to the producer. Saving the Farm Credit System and the banks while sacrificing our family farms will not work. We need a farm program that injects profitability, not one that lowers prices as the administration is proposing. Credit can only be serviced by profits.

Secondly, terminate the falling land values by placing these potentially problem loans in a holding company. Lease back the land to the farmer with an option to repurchase it at a later date.

Thirdly, use CCC stocks of grain, that are costing approximately $3 billion per year, to infuse capital into the agriculture sector or the FCS. Be creative and utilize them; they have been paid for once.

Fourth, initiate a program whereby the FCS can obtain lower cost funds thru issuing tax exempt bonds.

Fifth, give us a farm program that has an increased profit potential thru export initiatives, at least a $50,000 payment limitation supply management, and a $4.38 target price for four years with a market loan program. Only 1% of the federal budget is allocated for commodity price supports. Yet, agriculture essentially produces enough to pay for all government programs. Thanks to the efficiency of agriculture, the federal government is getting a 100 to 1 return on its investment.

I attended college 5 years obtaining a degree in agriculture economics and have spent the last 16 years getting over it. Possibly we all need to recover from our education and become realistic about the problems which we must face in the real world, living day to day. Time is running out on many of America's farmers and lending institutions. Action must take place very soon. I am not too optimistic. Those in government seem to react to crises more than meeting future needs. Let's act creatively, compassionately, fairly, and quickly. Let's save our country's greatest industry, American Agriculture!

STATEMENT OF JIM R. BILLINGTON, ALTUS, OK

I am here today as a farmer and rancher from Altus, Oklahoma. I am not inhibited in any way in what I have to say. No one has coerced me into a policy position and no one has helped me with this testimony.

I came for two purposes. (1) Encourage the Senate to pass its farm bill quickly, and (2) address the farm credit crisis.

We all know there is a credit crisis. Suddenly we all have good hindsight and know what should have been done to prevent the crisis. We all can find someone to blame and to criticize. But, that will not solve the problem.

We have an income problem in agriculture. For years we in farming and ranching have been seeking assistance and we have been heard by farm state legislators, but the remedies and other influences outside our control have been grossly inadequate. The situation has become so serious that we are finally gaining the support of rural America and all the agricultural infra-structure. We need the Senate to pass their farm income support bill that will help restore confidence in rural America.

If strong and costly remedies are not forthcoming soon, I predict the problem will become much, much worse and will become worse sooner than next spring. I am assured that we will have more allies as this cancer spreads to other areas of our economy.

We need a farm bill and a good one. We need target prices. We need the approach that is found in Senator Boren's legislation. We do not, as the administration has proposed, need a reduction in payment limitations; we need an increase. We also need the strong support of the Senate with this farm legislation to help restore confidence, and we need it now!

That, in my opinion, would be a strong move in the direction of improving rural confidence and in helping financial institutions in making plans for winter and spring needs.

How can we be too critical of the Farm Credit Administration or any of our local bankers when our asset base suddenly vanishes and our income is devoured by high interest rates and other ruinously increasing costs. Can we really expect to get credit when our land has decreased in value by 50 percent, and even our cash income is insufficient to repay cash operating cost?

We need action, not words!

We also need a strong farm credit system that is locally owned and managed and responsive to the credit needs of its stockholder borrowers. I was once both a P.C.A. and Federal Land Bank member-borrower. It is fortunate for me that I do not have a loan.

This entity must be financially sound, it must have a competitive interest cost and it needs to have a sizable portion of the operating and land debt in farm country.

A one percent change in interest rates affects net income by $2 billion. The F.C.A. share equals $740 million annually. With the decreased confidence of board buyers, this cost is to be borne by system borrowers and will soon escalate if concrete decisive action is not forthcoming.

Where are representatives of this administration now when this crisis has been predicted for the last four years? They are hiding their heads in the sand as exports decline, credit cost escalate, land values crash and farmers go bankrupt in record numbers. Where are they when the great institutions such as Farm Credit and the rural banking structures, the farm suppliers, our local and regional cooperatives in increasing numbers and velocity go broke? What more evidence do you need?

Will it take another drastic change in our country, such as was experienced in the 1930's, to restore confidence in farmers, oil and gas and other extraction and manufacturing industries. Unless drastic action is taken to pass a decent, humane farm bill and prop up credit to reduce farm production cost you are jeopardizing the very basis for our existence.

We have enough words and solutions on the table. We know the problems. Let us now take action.

JOINT STATEMENT OF NATIONAL CORN GROWERS ASSOCIATION, NATIONAL ASSOCIATION OF WHEAT GROWERS, NATIONAL COTTON COUNCIL, NATIONAL CATTLEMEN'S ASSOCIATION, NATIONAL GRANGE, AND NATIONAL WOOL GROWERS ASSOCIATION

Financial Conditions in Agriculture:
The Agricultural Credit Crisis

This statement is submitted on behalf of several agricultural organizations that are extremely concerned over the financial state of agriculture, and the viability of the lending institutions serving agriculture. Our members are the agricultural families who account for the greatest part of agricultural production in the United States. Our members are the borrowers from the commercial banks, the Farm Credit System and the trade creditors--we must bear the consequences of any plan to resolve the credit problem.

A reasonable question for you to ask is first, why we are concerned, and second, why should Congress and taxpayers and consumers of the U.S. be concerned about the agricultural financial crisis? A brief look at the statistics on the financial crisis in American agriculture provides reason enough for concern. We have reviewed several economic analyses of the problem, including some prepared by the USDA, and we find the information frightening. This problem is larger than most of us care to contemplate.

The absolute level of agricultural debt is large at $210 billion. The share that is at risk is significant--just under 25 percent of total debt. Recent economic studies indicate that up to $50 billion in agricultural credit may be unserviceable under even the best of economic conditions that might be realistically expected.

Trying to handle this much "at risk" debt does more than financially strain a few farmers. The unsustainable debt also puts lending institutions, local communities, and agribusiness concerns at risk. The loss of jobs and disruption of communities, which is now significant in many parts of the country, if forcing a tremendous and tragic change on rural America.

The data in the attached tables show where the problem is and who holds the debt. We think this information is a shocking statement on how severe the agricultural financial situation is at present.

It is particularly instructive to look, in Table 1, at which lenders hold the bad debt or the debt "at risk" of full or partial loss. It is not, contrary to popular opinion, confined to a certain segment--the credit problem extends to all sectors of lending and all areas of agricultural production.

Debt concentration by type of farming operation is shown in Table 2. One conclusion that can be drawn from this table is that the commercial producers--the full-time family farmers and ranchers that account for over 70 percent of agricultural production--are hardest hit by the present financial stress.

Debt concentration by region can be seen in Table 3. While some areas of the country appear to be harder hit, no area is unhurt. This problem exists throughout the U.S.

The problem exists for all sectors of agricultural production and lending. As a result, Congress cannot afford to focus on one sector to the exclusion of the others, nor can it focus on one region to the exclusion of others. Any kind of relief package must account for borrowers, and for the different kinds of lenders, throughout the country.

As agricultural organizations representing primarily the producer/borrowers, we have been meeting to discuss the criteria which we think are appropriate to evaluate the various credit proposals that will be considered. We are also working on a credit relief package that the agricultural groups can accept and support. Any package so developed will meet the criteria we are about to outline. We expect to have a proposal for your consideration within the next few weeks.

We urge you to also consider these criteria as you address the credit problem. The focus of the criteria is on establishing an agricultural credit relief proposal that is helpful and acceptable to agricultural producers. The criteria are general, but succinct.

Any solution must focus on the agricultural producers who are under financial stress, but who may survive with some assistance. Those who can survive must be helped, but not through more credit; instead, they need help to handle existing debt. Any legislation must be targeted toward maintaining the financial viability of these farming operations. Debt reduction, interest rate relief and financial counseling will help many of these producers.

Some form of transitional assistance should be considered to help those whose debts are greater than can realistically be repaid from their farming operations, and who must leave agriculture. This transitional assistance may also be the least cost and best means of easing the pain of the restructuring that is presently underway.

High interest rates on agricultural loans must be reduced. Interest rates charged agricultural producers in many areas currently range to as much as 6 points above rates paid by other industries. Part of this may be due to inherently great risk in agriculture, but part of the difference may be symptomatic of structural problems in agricultural lending.

When viewed on a comparable cost basis, interest rates for agricultural production are substantially higher than long term rates of return on agricultural assets. This suggests continued erosion in farm asset values. Agricultural cannot return to financial health until interest rates are more in line with rates of return from the industry.

The farm bill is a necessary part of the solution, but it cannot resolve the whole problem. An understandable sentiment in Congress is to try to address credit through the Farm Bill. However, this is at best only a partial answer. The Farm Bill serves as a guide and risk management tool for some producers, but cannot begin to reach all segments of agriculture.

Farm programs can help maintain net farm income (at $20 - 25 billion). However, the federal farm programs only directly affect about 45 to 50 percent of all agricultural production. As outlined earlier, the credit problem affects all agricultural producers. It is not especially size or region specific--all producers are hurting.

Losses are occurring, will continue to occur and must be shared by all participants in agricultural credit; taxpayers, borrowers, shareholders, lenders, stockholders, etc. No one segment can withstand the losses that must be taken. Some means of equitable spreading this loss across the broad economy must be considered. We do not support a bailout for any segment either; we will all bean our share of the loss. We believe, however, that forcing too much of the loss on one group may create distortions in the general economy.

We cannot afford the demise of a sector forced to assume too much loss. For example, one source of jobs in rural communities its agribusiness concerns that service commercial agriculture. Forcing these firms out of business will only compound the problem for local communities trying to adjust and absorb the financial losses. Some attrition will be inevitable, but we need to avoid a domino effect.

A viable means for delivering credit to agriculture is important and must be maintained. This may mean a re-structuring of present agricultural credit institutions and relationships, but the result must accommodate the unique biological and cyclical nature of agriculture. This area is the most important, and cannot be forgotten in an attempt to handle the immediate problem. We encourage efforts to maintain present structures, and forgo abrupt structural changes until the financial viability of the agricultural credit sector is established.

Mechanisms to prevent this financial crisis from occurring again. Preventing this from occurring again is a difficult task, but we must try whatever steps possible to prevent it. We do not have an answer, but it appears to us that oversight and regulation must be improved, both for commercial banks and for the Farm Credit System. The only real long-term prevention is, of course, for agriculture to be profitable.

In conclusion, we urge you to recognize that the problem is massive, it cannot be looked at as a problem of only lending segment, and will require coordinated effort on a package of alternatives to be successful. The Agriculture Committees have the opportunity to take a leadership role in developing the package. We urge and hope that you will take a broad view of the problem, and the solutions that will be required.

Table 1: Agricultural Debt, and Agricultural Debt "At Risk"

Source	Total debt (bil $)	Estimated At Risk (bil $)
Farm Credit System	$ 70.0	$ 2 - 11
Commercial Banks	56.0	1.5 - 4
Farmer's Home Admin.	26.0	13 - 15
Insurance Companies	12.0	.5 - 2
Trade Credit	18.0	7 - 10
Individuals	28.0	4 - 8
Totals	$ 210.0	28 - 50

Source: The numbers are based upon USDA data, recent economic analyses and the published statements of the various lending institutions. These are not numbers generated by the agricultural groups; These are the range of estimates offered by lenders within the past few months.

Table 2: DEBT CONCENTRATION BY FARMING OPERATION

	TYPE			
	CROPS	BEEF	PORK	DAIRY
	D/A	D/A	D/A	D/A
GROSS SALES CLASS				
Less than 10,000	18.93	10.85	16.61	22.85
10,000 - 24,999	16.50	9.22	37.27	12.45
25,000 - 49,000	30.21	17.15	30.51	41.64
50,000 - 99,999	43.04	30.27	39.36	24.07
100,000 - 249,999	41.95	28.36	61.56	22.20
250,000 - 499,999	50.48	45.44	60.60	34.32
500,000 and over	32.40	44.32	36.16	33.36
All	36.07	19.45	47.56	25.58

*CROP PRODUCERS INDICATE GREATEST FINANCIAL STRESS IN MID RANGE FARMS FROM $50 TO $500 THOUSAND IN GROSS SALES.

*BEEF PRODUCERS HAVE LOWEST TOTAL DEBT TO ASSET BUT LARGER PRODUCERS, ABOVE $250 THOUSAND, INDICATE FINANCIAL PRESSURE.

*PORK PRODUCERS CARRY HIGHEST DEBT/ASSETS WITH TWO CLASSES IN THE HIGH STRESS CATEGORY, $100 TO $500 THOUSAND GROSS SALES.

*SMALL DIARY FARMS, $25 TO $50 THOUSAND INDICATE HEAVY FINANCIAL STRESS.

SOURCE: Farm Journal survey; December 1, 1984, and the Food and Agricultural Policy Research Institute (FAPRI).

NOTE: "Type" of operation based on percent of gross sales. For example, an operation was called a "CROP" farm if 70 percent of sales came from crop sales. For Beef and Dairy, 50 percent was used, and 30 percent for Pork.

Table 3: DEBT CONCENTRATION BY FARM SIZE

	REGION				WEIGHTED NATIONAL AVERAGE
	EAST	SOUTH	CENTRAL	WEST	
	D/A	D/A	D/A	D/A	D/A
GROSS SALES CLASS					
Less than 10,000	13.78	13.07	15.57	15.53	13.93
10,000 - 24,999	9.14	7.97	23.60	21.18	15.02
25,000 - 49,000	11.96	28.43	29.44	27.70	27.88
50,000 - 99,999	25.87	43.17	39.07	26.43	37.76
100,000 - 249,999	23.56	38.01	43.42	25.73	38.52
250,000 - 499,999	41.26	33.48	54.03	41.49	48.41
500,000 and over	13.64	22.93	43.45	43.15	35.19
All	20.85	25.30	38.37	28.32	31.80

*EAST HAS LOWEST DEBT/ASSET RATIO WITH HEAVIEST FINANCIAL STRESS IN $250 TO $500 THOUSAND.

*SOUTH INDICATES HIGHEST FINANCIAL STRESS IN $50 TO $100 THOUSAND.

*CENTRAL RELECTS HEAVIEST CONCENTRATION OF FINANCIAL PRESSURE STARTING AT $100 THOUSAND AND ABOVE.

*WEST INCIDATES GREATEST FINANCIAL STRESS IN FARMS ABOVE $250 THOUSAND.

SOURCE: See Table 2.